EDITOR'S NOTE

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No. 86-88-CFX
Status: GRANTED

Title: Citicorp Industrial Credit, Inc., Petitioner
v.
William E. Brock, Secretary of Labor

Docketed:
July 22, 1986

Court: United States Court of Appeals
for the Sixth Circuit

Counsel for petitioner: Lee, Rex E.

Counsel for respondent: Solicitor General

Entry	Date	Note	Proceedings and Orders
1	Jul 22 1986	G	Petition for writ of certiorari filed.
3	Aug 22 1986		Order extending time to file response to petition until September 21, 1986.
4	Sep 23 1986		Order further extending time to file response to petition until October 21, 1986.
5	Sep 18 1986		Brief amicus curiae of Natl. Commercial Finance Assn. filed
6	Oct 9 1986		Brief of respondent Brock, Sec. of Labor in opposition filed.
7	Oct 15 1986		DISTRIBUTED. October 31, 1986
8	Oct 16 1986	X	Reply brief of petitioner Citicorp Industrial Credit filed.
9	Nov 3 1986		Petition GRANTED.
			**
11	Nov 13 1986		Order extending time to file brief of petitioner on the merits until January 17, 1987.
12	Dec 17 1986		Record filed.
13	Dec 18 1986		Record filed.
14	Dec 18 1986		Certified copy of C. A. proceedings received.
15	Jan 6 1987	G	Motion of petitioner to dispense with printing the join appendix filed.
16	Jan 20 1987		Motion of petitioner to dispense with printing the join appendix GRANTED.
17	Jan 16 1987		Brief of petitioner Citicorp Industrial Credit filed.
18	Jan 17 1987		Brief amicus curiae of Natl. Commercial Finance Assn. filed
20	Feb 17 1987		Order extending time to file brief of respondent on the merits until March 13, 1987.
22	Mar 13 1987		Brief amicus curiae of AFL-CIO filed.
23	Mar 11 1987		SET FOR ARGUMENT. Monday, April 20, 1987. (1st case).
24	Mar 13 1987		Brief of respondent Brock, Sec. of Labor filed.
25	Mar 20 1987		CIRCULATED.
26	Apr 7 1987	X	Reply brief of petitioner Citicorp Industrial Credit filed.
27	Apr 20 1987		ARGUED.

86-88

No. ——

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

CITICORP INDUSTRIAL CREDIT, INC.,
Petitioner,

v.

WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTION PRESENTED

In conflict with the holdings of two other courts of appeals, the Sixth Circuit held that the "hot goods" provision of the Fair Labor Standards Act (29 U.S.C. § 215 (a)(1)) prohibits a secured creditor from selling inventory collateral unless the creditor pays the wages due its insolvent debtor's employees. The question presented is:

Whether, in enacting the Fair Labor Standards Act, Congress intended not only to establish minimum wage rates, but also to displace the rights of bona fide purchasers and lienholders established by state and other federal law.

LIST OF PARTIES

In addition to the parties identified in the caption of the case, Ely Group, Inc. and two entities identified as Ely Group subsidiaries, Rockford Textile Mills, Inc. and Ely & Walker, Inc., were named defendants in the Secretary's complaints. Neither Ely Group nor any Ely Group subsidiary participated in the proceedings below.*

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* Petitioner Citicorp Industrial Credit, Inc. is a wholly-owned subsidiary of Citicorp Banking Corporation, which is a wholly-owned subsidiary of Citicorp, a publicly-held corporation. Rule 28.1, Rules of the Supreme Court of the United States.

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UNITED STATES DEPARTMENT OF LABOR,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Citicorp Industrial Credit, Inc., through its counsel, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in these cases.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-16a) is reported at 788 F.2d 1200. The opinions of the district courts (App., *infra*, 18a-33a) are reported at 608 F. Supp. 215 (E.D. Tenn.), and 621 F. Supp. 22 (W.D. Tenn.).

JURISDICTION

The judgment of the court of appeals (App., *infra*, 17a) was entered on April 23, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 15(a)(1) of the Fair Labor Standards Act (29 U.S.C. § 215(a)(1)) provides:

> (a) After the expiration of one hundred and twenty days from June 25, 1938, it shall be unlawful for any person—
>
> (1) to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 206 or section 207 of this title, or in violation of any regulation or order of the Administrator issued under section 214 of this title; except that no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful;

Sections 6 and 7 of the Fair Labor Standards Act (29 U.S.C. §§ 206, 207), which prescribe minimum regular wage rates and overtime wage rates for covered employees, are reproduced in the appendix to this petition. App., *infra*, 36a-56a.

STATEMENT OF THE CASE

The Sixth Circuit has held that the Fair Labor Standards Act of 1938 ("FSLA") requires a commercial lender to pay the wages of its insolvent debtor's employees or

forfeit the value of inventory pledged as collateral to secure cash advances. In the nearly 50 years since the FLSA was enacted, no other court of appeals has interpreted the statute to require such a result—a result far removed from the manifest purpose of the Act to establish decent wages and hours for American workers. To reach this extraordinary conclusion, the Sixth Circuit explicitly rejected the holdings of both the Second Circuit and the Fourth Circuit. Furthermore, contrary to this Court's repeated admonitions, the Sixth Circuit's construction of the FLSA unnecessarily creates tension with the intended operation of other federal statutes, and displaces state law.

1. Ely Group, Inc. is a defunct manufacturer of hosiery and clothing. In December, 1983, petitioner Citicorp Industrial Credit, Inc. ("Citicorp") and Ely entered into a standard commercial financing agreement. C.A. App. 343-411; see *id.*, 340-342.[1] Ely granted Citicorp a security interest in its accounts receivable and inventory to secure repayment of loans to be made by Citicorp under the agreement. C.A. App. 356-357.[2] Citicorp perfected its security interest in accordance with applicable state law by filing a financing statement with appropriate state officials. App., *infra*, 2a, 19a-20a; C.A. App. 33, 44, 75, 418.

Ely defaulted on its obligations under the financing agreement, and on February 11, 1985, Citicorp notified Ely that no additional funds would be advanced. C.A. App. 412-413. Citicorp was then entitled to take possession of its collateral, including Ely's inventory. At the request of Ely's management, however, Citicorp refrained from exercising its right to take possession of the inventory,

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[1] "C.A. App." refers to the joint appendix filed in the court of appeals. When the financing agreement was executed, Ely Group was known as Qualitex Corporation. App., *infra*, 2a.

[2] Under the agreement, payments from Ely's customers were deposited in a Citicorp account, and applied against the advances made by Citicorp. C.A. App. 189-190, 208-209, 321-322.

in order to give Ely an opportunity to devise a plan to continue operating and to pursue alternative sources of financing. C.A. App. 301-302.

Approximately one week later, on February 19, 1985, Ely ceased operations, and Citicorp took possession of its inventory collateral. App., *infra*, 3a. Ely had failed to pay its employees for work performed between February 3 and February 19, 1985. App., *infra*, 27a, 29a-30a.[3] In accordance with the terms of the financing agreement and applicable state law, Citicorp proposed to collect Ely's receivables, liquidate Ely's inventory, and apply the proceeds to the outstanding Ely loan balance of approximately $9.5 million. See App., *infra*, 3a.

2. In March, 1985 respondent Secretary of Labor filed two suits under §§ 15, 16, and 17 of the Fair Labor Standards Act (29 U.S.C. §§ 215, 216, 217) against Citicorp and Ely in the United States District Courts for the Eastern District of Tennessee and the Western District of Tennessee.[4] In both actions, the Secretary sought injunctive relief, and unpaid wages and liquidated damages on behalf of Ely employees. C.A. App. 4-7 (E.D. Tenn.), 110-114 (W.D. Tenn.).

Sections 6 and 7 of the FLSA prescribe minimum regular wage and overtime wage rates for covered employees. 29 U.S.C. §§ 206, 207, App., *infra*, 36a-56a. Section 15(a)(1), one of several mechanisms Congress adopted to induce employers to comply with these substantive provisions of the Act, makes it unlawful for "any person"

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[3] Some Ely payroll checks issued on February 8 were dishonored for insufficient funds; no payroll checks were issued after that date. C.A. App. 120, 281.

[4] *Donovan* v. *Rockford Textile Mills, Inc., Ely Group, Inc., and Citicorp Industrial Credit, Inc.*, Civ. Action No. 4-85-26 (E.D. Tenn.) (complaint filed March 15, 1985); *Ford* v. *Ely Group, Inc., Rockford Textile Mills, Inc., Ely & Walker, Inc., and Citicorp Industrial Credit, Inc.*, Civ. Action No. 85-2276H (W.D. Tenn.) (complaint filed March 21, 1985).

to transport, sell, or ship in commerce goods produced by employees not paid the prescribed minimum wages.

It is undisputed that Ely's wage rates satisfied the requirements of §§ 6 and 7 of the FLSA. C.A. App. 34; see App., *infra*, 13a. There is no evidence of wrongdoing by Citicorp, or of any participation by Citicorp in Ely management's decisions concerning the use of funds to pay employees or other creditors. App., *infra*, 25a-26a, 32a; see App., *infra*, 10a. The Secretary's theory is that an insolvent employer's failure to pay his employees, in breach of their respective employment contracts, violates the minimum wage and overtime provisions of the FLSA. On the basis of that asserted violation of §§ 6 and 7 by Ely, the Secretary invoked § 15(a)(1) against Citicorp, arguing that because § 15(a)(1) makes it unlawful for "any person" to sell goods produced in violation of the Act, Congress intended it to apply to secured creditors who have nothing to do with either the establishment or the payment of employee wages. According to the Secretary, therefore, when a creditor takes possession of "tainted" goods pursuant to a valid security agreement, the creditor may sell the collateral only if its debtor's employees are first paid.

Both district courts accepted the Secretary's theory, and enjoined Citicorp from selling any Ely inventory produced during the period for which Ely employees had not been fully paid.[5] Over the opposition of the Secretary, the district court judgments were stayed pending appeal. Citicorp was permitted to sell the inventory on condition that it hold the proceeds of all sales in a separate account and agree to pay the statutorily required wages due Ely employees if § 15(a)(1) were held applicable.[6]

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[5] *See* page 4, note 3, *supra*; C.A. App. 79-80, 427.

[6] App., *infra*, 4a; C.A. App. 104-105, 432-433; *see* App., *infra*, 10a n.9 ("Citicorp . . . removed the 'taint' from the goods by

3. The cases were consolidated for briefing and oral argument in the United States Court of Appeals for the Sixth Circuit. In affirming the district court judgments, the court of appeals explicitly rejected the holdings of the Second Circuit in *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730 (2d Cir. 1966), and the Fourth Circuit in *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971), both of which held § 15(a)(1) inapplicable to secured creditors that had foreclosed on goods produced by their debtors in violation of the FLSA. App., *infra*, 7a-8a. The court of appeals recognized that "Congress never directly considered the question whether the 'hot goods' provision [29 U.S.C. § 215(a)(1)] applies to secured creditors." App., *infra*, 12a. Nonetheless, relying on the general language of § 15 and its view that enforcing § 15(a)(1) against a secured creditor that had nothing to do with employee wages would further Congress' purpose to protect business from competition from goods produced under substandard labor conditions, the majority held that Citicorp was subject to injunction under § 15. App., *infra*, 4a-7a.[7]

Judge Engel dissented, arguing that after twenty years of settled law in this area, the court should follow the controlling construction of the FLSA adopted by the courts of appeals for the Second Circuit and the Fourth Circuit, absent compelling reason for rejecting that view. Given the length of time the rule established in *Powell*

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agreeing to pay the statutorily required wages if . . . 29 U.S.C. § 215(a)(1) applies to secured creditors"). Subsequently, the conditions of the stay were modified to allow Citicorp to reduce the amount of money held separate for payment of Ely employee-wage claims to $1.5 million. App., *infra*, 34a-35a.

[7] By permitting Citicorp to sell the inventory on condition that it agree to pay the Ely employees' unpaid, statutorily required wages if § 15(a)(1) were held applicable, the court of appeals implicitly rejected any suggestion that the inventory was either inherently or permanently "tainted" contraband.

Knitting had governed and the nature of the commercial practices that would be affected, Judge Engel emphasized the obvious "need for a uniform national construction of the Act . . . ." App., *infra*, 15a.

Judge Engel explained that the majority's holding effectively "create[d] a judicial lien superior to the otherwise lawful lien which Citicorp possessed in the goods." App., *infra*, 15a.[8] In Judge Engel's view, the Secretary's only "motivation" for invoking § 15 against a secured creditor of a financially distressed employer was to pressure the creditor to pay the wages of its debtor's employees. App., *infra*, 15a.[9] As the majority conceded, there was no evidence Congress intended § 15 to apply to a secured creditor. Accordingly, Judge Engel concluded that Congress intended to permit the claims of employees of insolvent corporations to be governed by "traditional sources of law," namely, "[s]tate laws governing creditors' rights, state laws protecting employees from non-payment of wages and bankruptcy laws generally." App., *infra*, 15a. Moreover, Judge Engel argued, the minimum wage provisions of the Fair Labor Standards Act were never intended to apply to an insolvent employer, unable to pay any wages at all. App., *infra*, 13a.

REASONS FOR GRANTING THE PETITION

The holding of the court of appeals admittedly conflicts with the well-settled construction of § 15 of the Fair Labor Standards Act adopted by both the Second Circuit and the Fourth Circuit. The question presented is important to both government and private secured lenders throughout the country. The court of appeals has estab-

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[8] *See also* C.A. App. 57 (counsel for the Secretary noted "[w]e're saying employees have priority").

[9] In the district court, the Secretary was explicit. Although an injunction entered under § 15(a)(1) would not "order any payment by anyone," it "puts pressure on either party [*i.e.*, the employer and the secured creditor] to arrange for payment [of employees' wages]." C.A. App. 42-43; *see also* C.A. App. 57, 58, 67.

lished an off-record, and therefore "secret" federal employee-wage lien or trust that appears to take priority over all other consensual, statutory, and judicial liens.

Moreover, the Sixth Circuit's construction of this important enforcement provision of a national statute is indefensible. The FLSA deals with wages and hours. It does not deal with lien priorities. Yet, the Sixth Circuit's construction of the FLSA necessarily will interfere with the operation of federal and state statutes specifically intended to govern lien priorities, including, for example, the Federal Tax Lien Act of 1966, the Packers & Stockyards Act, the Perishable Agricultural Commodities Act, and Article 9 of the Uniform Commercial Code.

1. The court of appeals recognized that its holding in these cases is in square conflict with the holdings of the Second Circuit and the Fourth Circuit, expressly refusing to follow those courts. App., *infra*, 7a-8a. On facts that are indistinguishable from those presented here, the Second Circuit rejected the first attempt by the Secretary of Labor to use § 15(a)(1) as a club to coerce a secured creditor to pay the wages of employees of its insolvent debtor. *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730, 733 (2d Cir. 1966). Powell Knitting was a sweater manufacturer. In the three weeks before it ceased operations, Powell Knitting failed to pay its employees. Meinhard Commercial Corporation, a commercial factor, had made loans to Powell Knitting of approximately $700,000, secured by Powell's inventory and equipment. When Meinhard foreclosed on its inventory collateral, the Secretary filed suit to enjoin Meinhard from selling the inventory in violation of § 15(a)(1) of the FLSA.

The Second Circuit held § 15 inapplicable to a secured creditor in such circumstances. The court recognized that the "only reason" for invoking § 15 to prevent a secured creditor from disposing of its collateral would be to force the creditor to pay employee wage claims, and that such

a use of § 15 was no more than a "backhanded way" of subordinating the creditor's secured claims. 360 F.2d at 733. There was no evidence Congress had ever even considered such a use of the Fair Labor Standards Act. The Second Circuit therefore rejected the Secretary's assertion that Congress intended to force a secured creditor "to pay the wage earners to avoid § 15." *Id.*

The Fourth Circuit agrees with the Second. *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971). Thus, if the Ely inventory had been located in any of the states comprising the Second Circuit and the Fourth Circuit, Citicorp would have been free to sell its collateral, without paying the wages of Ely's employees.

2. The question presented is important to government lenders and private commercial lenders throughout the country. Moreover, its importance is bound to increase. Now that a court of appeals has upheld the Secretary's authority to enforce the "hot goods" provision against secured creditors, it is fair to assume the Secretary will not confine his use of this new power to states comprising the Sixth Circuit, but will press for adoption of the new rule in other circuits as well. See page 21, note 36, *infra*.

As Professor Gilmore has commented: "It is an observable fact of business life that a doomed enterprise, during the last few months before the final descent into 'hopeless insolvency,' typically succeeds in piling up a large amount of unsecured debt." 1 G. Gilmore, *Security Interests in Personal Property* 259 (1965).[10] Since employees usually are not paid in advance, some part of the unsecured debt of most defunct employers will be payroll. See, *e.g.*, *Donovan* v. *Agnew*, 712 F.2d 1509 (1st Cir. 1983). If, as the Sixth Circuit held, the FLSA establishes, in effect, a federal lien on all goods "pro-

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[10] In 1984, approximately 52,000 businesses failed, with outstanding liabilities in excess of $29 billion. *See The Dun & Bradstreet Record of Business Closings* (March 12, 1986).

duced" by unpaid employees—a lien that takes priority over a previously perfected security interest—secured creditors of insolvent employers always will confront the risk of "secret" employee liens for unpaid wages superior to their security interests.[11] Until the Sixth Circuit's decision in these cases, it had been settled law that § 15(a)(1) did not apply to secured creditors or establish a federal lien or trust for employee-wage claims. The Sixth Circuit's contrary decision has introduced substantial uncertainty for both government and private secured creditors throughout the country.[12]

To accommodate their lending practices to the new priority rule, lending institutions must be able to determine whether the rule, however erroneous, has any application outside the Sixth Circuit. Uncertainty as to the interpretation of a national statute potentially affecting every secured financing arrangement throughout the country is intolerable. "In structuring financial transactions, businessmen depend on state commercial law to provide the stability essential for reliable evaluation of the risks involved." *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 739 (1979). Thus, it is particularly true in commercial finance that "it is more important that the applicable rule of law be settled than that it be settled

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[11] Under § 3(j) of the FLSA, the term "produced" is broadly defined to mean "produced, manufactured, mined, handled, or in any other manner worked on in any State; and for the purposes of [the FLSA] an employee shall be deemed to have been engaged in the production of goods if such employee was employed in producing, manufacturing, mining, handling, transporting, or in any other manner working on such goods, or in any closely related process or occupation directly essential to the production thereof, in any State." 29 U.S.C. § 203(j). Thus, the federal wage-lien created by the Sixth Circuit extends to any goods "worked on" in any manner by any covered employee.

[12] Although federal law governs the priority of liens arising from federal lending programs, state law generally provides the rule of decision. *E.g., United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979).

right." [13] After nearly a half century, a settled construction of a national statute should be changed, if at all, only by Congress.[14]

The impact of the Sixth Circuit decision on both existing and prospective lending is fairly predictable. Particularly in labor-intensive industries, in which the normal outstanding payroll is a relatively larger percentage of unsecured debt, the rule adopted by the Sixth Circuit will tend to discourage secured lending and increase the costs to borrowers.[15] Having entered into financing arrangements on the basis of prior law, without any hint that the rule firmly established 20 years ago in *Powell Knitting* might be challenged, the national commercial financing community must reevaluate existing and prospective loans in light of the increased risks created by the Sixth Circuit's decision. Evaluation of the adequacy of security and therefore the availability of additional funding as well as determination of the appropriate interest rates are necessarily affected by this increased risk.

The impact of the Sixth Circuit's unprecedented construction of the FLSA on the intended operation of other federal statutes underscores the need for review. For,

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[13] *Square D Co.* v. *Niagara Frontier Tariff Bureau, Inc.*, 106 S. Ct. 1922, 1931 (1986), quoting *Burnet* v. *Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting); *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 739-740 (1979); *see also United States* v. *Maine*, 420 U.S. 515, 528 n.9 (1975) ("the doctrine of *stare decisis* carries particular force where the effect of reexamination of a prior rule would be to overturn long-accepted commercial practice").

[14] *E.g., Square D Co.* v. *Niagara Frontier Tariff Bureau, Inc.*, 106 S. Ct. 1922, 1030-1931 (1986); *Herman & MacLean* v. *Huddleston*, 459 U.S. 375 (1983); *see Donovan* v. *Agnew*, 712 F.2d 1509, 1514 (1st Cir. 1983).

[15] *See generally* T. Jackson & A. Kronman, *Secured Financing and Priorities Among Creditors*, 88 Yale L.J. 1143, 1147-1149, 1163 (1979).

as this Court recently reiterated, "where . . . statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1018 (1984) (internal quotation marks omitted). In the Packers and Stockyards Act, Congress provided that "livestock purchased by a packer in cash sales, and all inventories of, or receivables or proceeds from meat . . . shall be held by such packer in trust for the benefit of all unpaid cash sellers of such livestock until full payment has been received by such unpaid sellers" (7 U.S.C. § 196(b)). Under the Sixth Circuit's interpretation of the FLSA, however, the unpaid livestock vendor could be enjoined from recovering and selling his cattle or the products thereof if the defaulting packer has failed to pay his employee, or, as in this case, has discontinued operations for financial reasons. Congress' specific intention under the Packers and Stockyards Act to protect sellers of cattle would thereby be frustrated. The same conflict would exist as to the trust for unpaid growers that Congress established in the Perishable Agricultural Commodities Act, 7 U.S.C. § 499e(c). Similarly, the lien that attaches to inventory pursuant to the Federal Tax Lien Act of 1966, 26 U.S.C. §§ 6321, *et seq.*, could be impaired if the taxpayer has failed to pay his employees. Further, because a federal tax lien is subordinate to the prior perfected security interest of a commercial lender, 26 U.S.C. § 6323(a), (c), the Sixth Circuit's construction of the FLSA may produce unintended and highly undesirable "circular priority" problems. See generally 2 G. Gilmore, *Security Interests in Personal Property* 1020-1046 (1965).[16]

[16] A federal tax lien is subordinate to the prior perfected security interest of a commercial lender, but the tax lien is superior to later unsecured employee-wage claims. The employee wage claims (according to the Sixth Circuit) would be superior to the senior security interest. Further, if this circularity of liens and claims existed when bankruptcy proceedings were initiated, the Sixth Circuit's rule would disrupt the Bankruptcy Code priority system, again contrary to Congress' clearly expressed intentions. *See generally* 3 *Collier on Bankruptcy* ¶ 507.03 (15th ed. 1986).

3. *a.* Traditionally, employee wage liens and the order of payment of creditors of insolvents have been governed by state law and federal bankruptcy law. These laws reflect the judgments of state legislatures and Congress as to the appropriate degree of protection to be afforded unpaid employees of financially distressed corporations. By contrast, the focus of the FLSA is minimum wage rates. It defies common sense to suggest that, in prescribing minimum wage and hour standards, Congress could have intended to displace otherwise controlling federal bankruptcy and state insolvency laws.

The Sixth Circuit's construction of § 15(a)(1) is not only wrong, but also inconsistent with Congress' policy of placing wage claims behind perfected security interests in bankruptcy and, outside the bankruptcy context, generally leaving creditors' rights and priorities to state legislation. As Judge Engel recognized, the majority effectively "create[d] a judicial lien" or secret trust for employee-wage claims, which is inconsistent with a substantial body of state law governing creditors' rights. When Congress has intended to supersede state law governing the priority of creditors' claims or to create off-record, "secret" trusts or liens to assure payment of particular creditors, it has done so explicitly, with due regard to the interests of both secured creditors and otherwise controlling state law.[17] Absent persuasive evidence

[17] *See Mahon* v. *Stowers*, 416 U.S. 100 (1974) (holding that Congress did not intend to establish a secret trust or lien to assure payment of cattlemen in the Packers & Stockyards Act, 7 U.S.C. § 181). In 1976, Congress amended the Packers & Stockyards Act to create a statutory trust on the proceeds of sale for unpaid cattlemen. 7 U.S.C. § 196. Similarly, in 1984 Congress explicitly created a statutory trust for the protection of vendors of certain agricultural commodities. Perishable Agricultural Commodities Act, 7 U.S.C. § 499e(c). *See also* Section 3466 Rev. Stat., 31 U.S.C. § 3713; Federal Tax Lien Act of 1966, 26 U.S.C. §§ 6321-6323.

that Congress intended to displace state law governing the priorities of creditors of insolvent corporations (not in bankruptcy), the general language of a federal statute should not be construed to have such an effect.[18]

Article 9 of the Uniform Commercial Code has been adopted by every state legislature in the country (except Louisiana), and by Congress for the District of Columbia.[19] Under Article 9 secured creditors generally are entitled to satisfaction of their claims out of property in which they have a perfected security interest before the property can be used to satisfy the claims of any general unsecured creditors, including, for example, employee-wage claims.[20] Further, notoriety by notice filing is criti-

[18] *See, e.g., Louisiana Public Service Commission* v. *FCC*, 106 S. Ct. 1890, 1899 (1986) ("[t]he critical question in any pre-emption analysis is always whether Congress intended that federal regulation supersede state law"); *Philko Aviation, Inc.* v. *Shacket*, 462 U.S. 406, 409-411 & nn.2-4 (1983); *In the Matter of Gary Aircraft Corp.*, 681 F.2d 365, 368-372 (5th Cir. 1982), *cert. denied*, 462 U.S. 1131 (1983) (Wisdom, J.) (rejecting contention that Federal Aviation Act established federal priority scheme in the absence of "strong reasons to believe that Congress intended to displace" state law in this area). *See generally Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2121 & nn.32-33 (1986) (plurality opinion); *Garcia* v. *San Antonio Metropolitan Transit Authority*, 105 S. Ct. 1005, 1018 (1985); *Kirschbaum Co.* v. *Walling*, 316 U.S. 517, 520-522 (1942); H. Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 Colum. L. Rev. 543 (1954).

[19] *See United States* v. *Kimbell Foods, Inc.*, 400 U.S. 715, 732 n.28 (1979); *Slodov* v. *United States*, 436 U.S. 238, 257 n.22 (1978); *see generally* White & Summers, *Handbook of the Law Under the Uniform Commercial Code* 895 (2d ed. 1980).

[20] *See* Uniform Commercial Code, §§ 9-201, 9-301(1), 9-312, 9-501 to 9-507; *see generally* White & Summers, *Handbook on the Law Under the Uniform Commercial Code* 1030-1083 (2d ed. 1980). Secured creditors enjoy similar protection under the Federal Bankruptcy Code and its predecessor. *See generally 3 Collier on Bankruptcy* ¶¶ 506.02, 507.02, 507.03 (15th ed. 1986); 2 G. Gilmore, *Security Interests in Personal Property* 1051 (1965); *see also*

cal to the operation of Article 9, and to the underlying concept that a potential creditor should be able to determine the risks and the priorities of other creditors before extending credit. See, *e.g.*, *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 739 n.42 (1979). Accordingly, with few exceptions, Article 9 avoids undisclosed and effectively undiscoverable "secret" liens or trusts that may defeat the claims of creditors with perfected security interests.[21]

Moreover, in addition to Article 9 of the Uniform Commercial Code, there is a wide variety of state legislation specifically governing employee-wage liens. Most of this legislation antedates the Fair Labor Standards Act, and Congress doubtless was aware of it. The statutes reflect the many and varied policy judgments that state legislators have made in dealing with the difficult problems of who should be preferred to whom when there is not enough money to pay all the debts of an insolvent. For example, while some states extend protection to virtually all employees, others limit protection to employees in particular industries.[22] Other states limit the dollar amount of the claims for which protection is provided; some

Wirtz v. *Powell Knitting Mills Co.*, 360 F.2d 730, 733 (2d Cir. 1966).

[21] Mechanic's liens or repairmen's liens, which may take priority over a perfected security interest under § 9-310, are not "secret" in the sense in which the term is used here, because such liens are effective against a perfected security interest only if the goods are in the "possession" of the vendor. *E.g., Forrest Cate Ford, Inc.* v. *Fryar*, 62 Tenn. App. 572, 577, 465 S.W.2d 882, 884 (1970); *see generally* Note, *The Priority Rules of Article Nine*, 62 Cornell L. Rev. 834, 907-918 (1977); Note, *Nonconsensual Liens Under Article 9*, 76 Yale L.J. 1649, 1656 & n.34 (1967).

[22] *Compare* Pa. Stat. Ann. tit. 43, § 221 (Purdon 1964) (virtually all employees) *with* Ala. Code § 35-11-90 (1977) (railroad employees); Me. Rev. Stat. Ann. tit. 10, §§ 3201-4012 (1980 & 1985 Supp.) (miscellaneous specific categories); Miss. Code Ann. § 85-7-1 (1985 Supp.) (agricultural employees).

impose no limitation.[23] Before Article 9 was adopted, some states arguably would have given priority to an employee-wage lien over a previously perfected security interest; others clearly did not.[24]

The holding of the Sixth Circuit, effectively establishing a federal lien or trust for employee-wage claims with priority over earlier perfected security interests and, presumably, other consensual, statutory, or judicial liens, thus nullifies contrary policy judgments of state legislatures throughout the country. Surely that was not Congress' intention when it enacted a wage and hour law.

b. Neither the language of § 15(a)(1) nor its purpose requires the creation of a "secret" employee-wage lien, superior to the claims of secured creditors and contrary to state law.[25] Moreover, the legislative history of the

[23] *Compare* Cal. Civ. Code § 3061.5 (Deering 1985 Supp.) (agricultural laborers, two weeks earnings, 25% of value of severed crops, or 25% of sale proceeds, whichever is less); Del. Code Ann. tit. 10, § 4931 (1975) (New Castle County, $50 and one month); Minn. Stat. Ann. § 514.59 (West 1986 Supp.) ($1000 or 5 weeks net wages up to $3000, whichever is greater) *with* Alaska Stat. § 34.35.435 (1985) (clerk, accountant, bookkeeper, *et al.*); Ind. Code § 32-8-24-1 (1986 Supp.)

[24] *Compare* Alaska Stat. § 34.35.435 (1985); Ark. Stat. Ann. § 51-320 (1971); S.C. Code Ann. § 29-11-10 (1977); Tenn. Code Ann. § 66-13-101 (1982) *with* Del. Code Ann. tit. 8, § 300 (1975); Fla. Stat. Ann. § 713.58 (1986 Supp.); Ind. Code § 32-8-24-2 (1986 Supp.); Ga. Code Ann. § 44-14-380 (1982); Minn. Stat. Ann. § 514.59 (West 1986 Supp.); *see DiAngelo* v. *McCormick Bros., Inc.*, 168 A. 79 (Del. Ch. 1933); *Flynn-Harris-Bullard Co.* v. *Johnson*, 90 Fla. 654, 107 So. 358 (1925).

[25] In the court of appeals, the Secretary argued that Congress' failure to enact a limited proposal authorizing the Department of Labor to grant exemptions from § 15(a)(1) supported the conclusion that the provision was intended to apply to secured creditors. Br. for the Secretary of Labor pp. 30-34. The Sixth Circuit correctly rejected the contention. App., *infra*, 10a-11a n.10. The only plausible inference to be drawn from the omission is that the exemption authority was deemed unnecessary. In any case where the

provision and common sense confirm that it was not intended to be used to force any bona fide purchaser, including a secured creditor, to pay the wages of the employees of an offending employer. The focus of the FLSA was the wage rates of ongoing businesses, not the consequences of the inability of an employer that has ceased operations to pay its employees. Section 15(a)(1) of the FLSA provides that it is "unlawful for any person to transport . . . ship, deliver, or sell in [interstate] commerce . . . any goods in the production of which any employee was employed" in violation of the minimum wage and overtime provisions of the Act. 29 U.S.C. § 215(a)(1).[26] Consistent with the limits of the Commerce Clause, as understood in 1938, § 15(a)(1) was intended to establish a mechanism for enforcing the minimum wage and overtime standards of the FLSA against employers in the chain of production and distribution of goods in interstate commerce, unless specifically exempted.[27] Limited the reach of § 15(a)(1) to offend-

Secretary would have been authorized to grant an exemption, he could accomplish the same result by not seeking an injunction. *See also Weinberger* v. *Romero-Barcelo*, 456 U.S. 305, 313 (1982).

[26] When the FSLA was under consideration, there was substantial uncertainty as to whether this Court would sustain Commerce Clause legislation prescribing minimum wage, overtime, and child labor standards. *Compare Carter* v. *Carter Coal Co.*, 298 U.S. 238 (1936); *Schechter Poultry Co.* v. *United States*, 295 U.S. 495 (1935); *Hammer* v. *Dagenhart*, 247 U.S. 251 (1918), *with NLRB* v. *Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1937); *see also Fair Labor Standards Act of 1937, Joint Hearings Before the Senate Committee on Education and Labor and the House Committee on Labor on S. 2475 and H.R. 7200*, 75th Cong., 1st Sess. ("*1937 Joint Hearings*") 1-89 (1937) (statement of Robert H. Jackson, Asst. Atty. Gen.).

[27] As then Assistant Attorney General Robert H. Jackson explained, the draftsmen of the FLSA had attempted "to consolidate in a single bill all hopeful approaches to constitutionality, each complete in itself, so that if one or more falls at the hands of the Courts, we will not be left for an interval while a new bill is being

ing employers, however, would have provided an obvious and ready means of circumvention.

Assistant Attorney General Robert Jackson's explanation in 1937 of the intended operation of the legislation makes it clear that if § 15(a)(1) had prohibited shipment or sale in interstate commerce only by the employers who violated the wage and hour provisions, "the law would be a nullity, because they could farm out the parts of the work that they wanted to do under substandard conditions." *1937 Joint Hearings* at 87.[28] The subcontractor would produce goods under substandard conditions and sell the goods only within a state to its principal, who would then incorporate the goods into a finished product for shipment or sale in interstate commerce. See *1937 Joint Hearings* at 85-87.[29] The prohibition against interstate shipment and sales would have been inapplicable to the subcontractor and, if the provision had been limited to prohibiting shipment or sale by only the offending employer, it would not have prevented the shipment of the finished product by the principal

adopted." *1937 Joint Hearings* at 2; *see id.* at 50-53, 85. Senate Bill 2475, § 7(a), one of the predecessors to § 15(a)(1) of the FLSA, was based on Mr. Justice Holmes' dissent in *Hammer* v. *Dagenhart*. *Id.* at 58. Thus, if a majority of this Court had accepted Justice Holmes' analysis and all other "approaches to constitutionality" failed, the minimum wage and overtime provisions could have been enforced solely through § 15(a)(1), by prohibiting shipment or sale in interstate commerce of goods produced under substandard conditions.

[28] The "sweatshop" was one of the evils Congress hoped to eliminate by passage of the FLSA. "By the sweatshop is ordinarily meant a subcontractor; that is, a contractor who takes work from a principal and takes it out to do under contract in a shop which may be in his home or may be in hired premises." *1937 Joint Hearings* at 196 (statement of Secretary of Labor Frances T. Perkins).

[29] *See also Rutherford Food Corp.* v. *McComb*, 331 U.S. 722 (1947) (rejecting contract labels in determining whether workers are "employees" or "independent contractors" for purposes of the FLSA).

either. See *id.* at 86. Thus, § 15(a)(1) prohibits "any person" from selling or shipping goods produced under substandard labor conditions, "and the fact that you change the title by selling them from A to B before they go into interstate commerce does not affect it." *1937 Joint Hearings* at 87.[30] That was the purpose of the "hot goods" provision; it was not intended to nullify state lien statutes by establishing a federal employee-wage lien.

The court of appeals' suggestion that enforcing § 15 (a)(1) against a secured creditor serves any Congressional purpose to protect competitors is untenable. App., *infra*, 6a-7a, 10a. The FLSA had one purpose: to improve the conditions under which Americans worked by raising wages and reducing hours.[31] Congress was concerned about competitors only to the extent that competition from "chiselers" had the effect of driving wages down. The reference to "competition" in Congress' findings and declaration of policy reflects the attempt to invoke every "hopeful approach to constitutionality" for prescription of wages, overtime, and child labor standards. See *1937 Joint Hearings* at 80, 85.[32] The court of

[30] *See, e.g., Hamlet Ice Co.* v. *Fleming*, 127 F.2d 165, 167 (4th Cir.), *cert. denied*, 317 U.S. 634 (1942) (rejecting intrastate seller's attempt to avoid FLSA).

[31] *United States* v. *Rosenwasser*, 323 U.S. 360, 361 (1945) (citation omitted); *see Rutherford Food Corp.* v. *McComb*, 331 U.S. 722, 727 (1947); *Donovan* v. *Agnew*, 712 F.2d 1509, 1517 (1st Cir. 1983).

[32] The basis for Congress' exercise of jurisdiction under the Commerce Clause was its finding that the existence of substandard "labor conditions" in industries "engaged in commerce or in the production of goods for commerce . . . (1) causes commerce and the channels and instrumentalities of commerce to be used to spread and perpetuate such labor conditions among the workers of the several States; (2) burdens commerce and the free flow of goods in commerce; (3) constitutes an unfair method of competition in commerce; (4) leads to labor disputes burdening and ob-

appeals thus confused the mechanism for enforcement and the jurisdictional basis of the FLSA with its purpose. Moreover, even if Congress was concerned about protecting business against competition from goods produced under substandard conditions, enforcing § 15(a)(1) against a secured creditor would not further that purpose. The debtor's costs of production are totally irrelevant to the foreclosing creditor, whose interest is to sell the goods at the best possible price, not to sell the goods cheaply to increase its market share and profits. Compare App., *infra*, 14a-15a.

The history of the FLSA before and after *Powell Knitting* confirms that it was never intended to affect the priority of perfected security interests in inventory of insolvent debtors. From 1938 to 1966, neither the Secretary of Labor nor anyone else read § 15(a)(1) to apply to secured creditors. See *Wirtz* v. *Powell Knitting*, 360 F.2d at 733.[33] In 1966, the Second Circuit rejected what appears to have been the first attempt to extend the reach of the Fair Labor Standards Act to secured creditors. The holding of the court of appeals in *Powell*

structing commerce and the free flow of goods in commerce; and (5) interferes with the orderly and fair marketing of goods in commerce." 29 U.S.C. § 202(a). *See, e.g., Maryland* v. *Wirtz*, 392 U.S. 183, 188-193 (1968); *United States* v. *Darby*, 312 U.S. 100, 109-110, 122 (1941).

[33] The 1949 amendment to § 15(a)(1) provides no support for the court of appeals' decision. *See* App., *infra*, 11a-12a. The amendment permits a good faith purchaser in the ordinary course of business to avoid any potential application of § 15(a)(1) by simply having the seller stamp or print on its invoice that its employees have been paid in accordance with the minimum wage and hour provisions. *See* 29 C.F.R. § 789.4 (1984). Congress thus confirmed what was manifestly implicit in the Act, as adopted in 1938, namely, that § 15(a)(1) was never intended to be invoked against innocent purchasers. There is no reason to believe that by expressly excluding the most obvious and common class of likely innocent purchasers, Congress thereby broadened the intended scope of § 15(a)(1).

Knitting remained settled law until the Sixth Circuit's decision in these cases.[34]

Thus, for almost 50 years it has been clear that the "hot goods" provision of the FLSA has no application to secured creditors. Congress is presumed to have been aware of the Second Circuit's holding in *Powell Knitting*.[35] Although the Fair Labor Standards Act has been amended several times since *Powell Knitting* was decided 20 years ago, Congress has not modified § 15(a)(1). Nor does it appear that the Secretary has sought legislation to overrule *Powell Knitting*.[36] Congress' failure to amend § 15(a)(1) is additional and persuasive evidence that the provision was never intended to establish a "secret" lien or trust for employee-wage claims, or to be used as a club to force a secured creditor to pay its debtor's employees.

[34] In 1971, the Fourth Circuit rejected another attempt by the Secretary to extend the reach of the Fair Labor Standards Act. *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971).

[35] *See Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2113 (1986) (plurality opinion); *Cannon* v. *University of Chicago*, 441 U.S. 677, 696-697 (1979).

[36] Instead, the Secretary filed these cases, in the words of Mr. J. Dean Speer, Department of Labor Area Director, because *Powell Knitting* "was a 1966 decision, [and] we needed to make some new law." C.A. App. 263.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari to the Sixth Circuit should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Nos. 85-5249 & 85-5252

WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
Plaintiff-Appellee,

v.

ELY GROUP, INC., ROCKFORD TEXTILE MILLS, INC.,
ELY & WALKER, INC.,
Defendants,

CITICORP INDUSTRIAL CREDIT, INC.,
Defendant-Appellant.

On Appeal from the United States District Courts
for the Eastern and Western Districts of Tennessee

Decided and Filed April 23, 1986

Before: ENGEL, KENNEDY and RYAN, Circuit Judges.

KENNEDY, Circuit Judge, delivered the opinion of the court, in which RYAN, Circuit Judge, joined. ENGEL, Circuit Judge, (pp. 13-16) delivered a separate dissenting opinion.

KENNEDY, Circuit Judge. These consolidated appeals present the question whether section 15(a)(1) of the Fair Labor Standards Act ("FLSA"), as amended, 29 U.S.C. § 215(a)(1), applies to holders of collateral obtained pursuant to perfected security interests. The United States District Courts for the Eastern and Western Districts of Tennessee held that the FLSA applies to secured creditors. For the reasons set forth below, we affirm.

On December 14, 1983, defendant-appellant, Citicorp Industrial Credit, Inc. ("Citicorp"), and Qualitex Corporation, an earlier name for a group of companies consisting of Ely Group, Inc. ("Ely Group") and its subsidiaries, Rockford Textile Mills, Inc. ("Rockford") and Ely & Walker, Inc. ("Ely & Walker"), (collectively "Ely"), signed a financing agreement. Under this "zero balance" [1] financing arrangement, Citicorp agreed, in its discretion, to loan up to $11,000,000 to provide the general working capital for Ely. As security for the loans, Ely granted Citicorp a security interest in inventory, accounts receivable, and various other assets. Citicorp filed financing statements and other appropriate documentation to perfect its security interests so that Citicrop undisputably qualifies as a perfected secured creditor.

In accordance with the financing agreement, Ely submitted various daily, weekly, and monthly reports to Citicorp. In the fall of 1984, Ely started missing sales projections. Accordingly, the loan balance considerably exceeded projections. In January 1985, Ely stopped sending reports to Citicorp. A Citicorp field examination determined that Ely's computerized accounting system was not functioning properly. By early February 1985, Ely's loan balance had increased to approximately $9,500,000. February 8, 1985 was the last day Citicorp advanced any funds to Ely. On February 11, 1985, Citicorp ceased funding Ely's operations. Ely's employees, however, continued working until February 19, 1985, when Citicorp foreclosed, taking possession of the collateral, and Ely ceased operations.

[1] Under a "zero balance" financing arrangement, the creditor transfers funds, on a daily or an "as needed" basis, into the debtor's "zero balance" bank account to meet the debtor's operating expenses. Accordingly, each day, after Ely's various banks informed Ely of the total amount of checks which had cleared, Ely personnel would notify Citicorp of the amount needed to cover those checks. Citicorp, in turn, would wire-transfer the necessary funds to Ely's bank accounts to fund Ely's disbursements, including payroll checks.

Since Ely defaulted on its payroll, its employees did not receive any wages for various workweeks, dating from January 27, 1985 to February 19, 1985. Consequently, the goods that Ely produced during this period were produced in violation of the FSLA's minimum wage and overtime provisions.[2] Acting on information that Citicorp planned to ship the goods in interstate commerce, the Department of Labor brought these actions to enjoin the shipment of the goods under 29 U.S.C. § 215(a)(1).

On March 15, 1985, Raymond J. Donovan, Secretary of Labor, United States Department of Labor,[3] filed a complaint and a motion for preliminary injunction and application for temporary restraining order in the United States District Court for the Eastern District of Tennessee, to enjoin Rockford, Ely Group, and Citicorp from placing goods allegedly produced in violation of the FLSA's minimum wage and overtime provisions in interstate commerce. The District Court denied the ap-

[2] FLSA § 6, codified at 29 U.S.C. § 206, requires employers to pay each employee minimum wages at the prescribed rate. FLSA § 7, codified at 29 U.S.C. § 207, requires employers to pay each employee one and one-half times the regular rate of pay for every hour in excess of forty hours that the employee works during a workweek.

[3] Pursuant to Fed. R. App. P. 43(c)(1), William E. Brock, Secretary of the United States Department of Labor, has replaced Raymond J. Donovan as a party in appeal No. 85-5249.

plication for a temporary restraining order on March 15, 1985. After hearing arguments, the District Court granted the motion for preliminary injunction on March 22, 1985. *Donovan v. Rockford Textile Mills, Inc.*, 608 F. Supp. 215 (E.D. Tenn. 1985). Citicorp filed a notice of appeal from that ruling, which the Clerk of this Court docketed as No. 85-5249. On April 10, 1985, the District Court granted Citicorp's motion for a stay or suspension of injunction pending appeal.

On March 21, 1985, Ford B. Ford, Under Secretary of Labor, United States Department of Labor,[4] filed a related complaint and motion for preliminary injunction and application for temporary restraining order in the United States District Court for the Western District of Tennessee against Ely Group, Rockford, Ely & Walker, and Citicorp. The District Court, following a telephone conference with counsel, granted the temporary restraining order on March 22, 1985. Following a hearing, the District Court granted the motion for a preliminary injunction on March 27, 1985. Citicorp filed a notice of appeal, which the Clerk of this Court docketed as No. 85-5252. On March 28, 1985, the District Court denied Citicorp's motion to stay or suspend the injunction. Citicorp immediately filed a motion for a stay pending appeal in this Court, agreeing to pay the unpaid employees the statutorily required wages in the event that this Court concluded that 29 U.S.C. § 215(a)(1) applies to Citicorp. This Court granted the requested stay on March 29, 1985.

Title 29 U.S.C. § 215(a)(1),[5] the FLSA's "hot goods" provision, prohibits "any person'" from shipping, de-

[4] In appeal No. 85-5252, William E. Brock has replaced Ford B. Ford as a party. *See supra* note 3.

[5] Title 29 U.S.C. § 215 provides in pertinent part:

(a) After the expiration of one hundred and twenty days from June 25, 1938, it shall be unlawful for any person—

livering, or selling, in interstate commerce, goods that were produced in violation of FLSA's minimum wage and overtime provisions. Title 29 U.S.C. § 203(a) defines "person" as "an individual, partnership, association, corporation, business trust, legal representative, or any organized group of persons." Citicorp thus falls within the "plain meaning" of the statute. Citicorp, however, cites *Church of the Holy Trinity v. United States*, 143 U.S. 457 (1892), for the proposition that this Court should look beyond the plain meaning of the statute. In *Church of the Holy Trinity*, the Supreme Court stated:

> It is a familiar rule that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers.

Id. at 459. *See also United Steelworkers of America v. Weber*, 443 U.S. 193, 201, *reh'g denied*, 444 U.S. 889 (1979). Although courts may look behind the "plain

(1) to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 206 or section 207 of this title, or in violation of any regulation or order of the Administrator issued under section 214 of this title; except that no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful . . . .

meaning" of a statute when a literal construction would produce a nonsensical result or "'bring about an end completely at variance with the purpose of the statute,'" *id.* at 202 (quoting *United States v. Public Utilities Commission*, 345 U.S. 295, 315, *reh'g denied*, 345 U.S. 961 (1953)), we conclude that applying the "hot goods" provision to secured creditors, in fact, furthers one purpose of the FLSA, which is to keep goods that were produced in violation of the FLSA out of interstate commerce.

In *United States v. Darby*, 312 U.S. 100 (1941), the Supreme Court, after examining the declaration of policy in § 2(a) of the FLSA, codified at 29 U.S.C. § 202(a),[6] and the FLSA's legislative history, stated that the purpose of the FLSA

> is to exclude from interstate commerce goods produced for the commerce and to prevent their production for interstate commerce, under conditions detrimental to the maintenance of the minimum standards of living necessary for health and general well-being; *and* to prevent the use of interstate commerce as the means of competition in the distribution of goods so

[6] Title 29 U.S.C. § 202(a) provides:

> The Congress finds that the existence, in industries engaged in commerce or in the production of goods for commerce, of labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers (1) causes commerce and the channels and instrumentalities of commerce to be used to spread and perpetuate such labor conditions among the workers of the several States; (2) burdens commerce and the free flow of goods in commerce; (3) constitutes an unfair method of competition in commerce; (4) leads to labor disputes burdening and obstructing commerce and the free flow of goods in commerce; and (5) interferes with the orderly and fair marketing of goods in commerce. That Congress further finds that the employment of persons in domestic service in households affects commerce.

> produced, and as the means of spreading and perpetuating such substandard labor conditions among the workers of the several states.

Id. at 109-110 (emphasis added). While discussing § 15 (a)(1) of the FLSA, the Court stated:

> The motive and purpose of the present regulation are plainly to make effective the Congressional conception of public policy that interstate commerce should not be made the instrument of competition in the distribution of goods produced under substandard labor conditions, which competition is injurious to the commerce and to the states from and to which the commerce flows.

Id. at 115. *See also Roland Electric Co. v. Walling*, 326 U.S. 657, 667-69 (1946). Consequently, one of the reasons that Congress passed the FLSA was to exclude tainted goods from interstate commerce. Since Congress wanted to exclude goods that were produced in violation of the FLSA's minimum wage and overtime provisions from interstate commerce, prohibiting secured creditors, such as Citicorp, from shipping "hot goods" in interstate commerce furthers that Congressional intent. Accordingly, we follow the "plain language" of the statute and conclude that the phrase "any person" applies to Citicorp, as a secured creditor.[7]

In reaching this conclusion, we refuse to follow and reject the reasoning of the Second Circuit in *Wirtz v. Powell Knitting Mills Company, Inc.*, 360 F.2d 730 (2d

[7] We also note that in *Dunlop v. Carriage Carpet Co.*, 548 F.2d 139, 144 (6th Cir. 1977), while discussing the definition of the term "employee," this Court recognized that: "In interpreting provisions of the Fair Labor Standards Act the courts have construed the Act's definitions liberally to effectuate the broad policies and intentions of Congress." This Court stated that Congress used "key definitions of great breadth and generality" to accomplish its stated goals. *Id.* at 143.

Cir. 1966). In *Powell Knitting Mills*, the Second Circuit created a "judicial exception" to the FLSA by holding that FLSA § 15 did not prohibit a factor, which had foreclosed its lien on an insolvent manufacturer, from selling the manufacturer's sweaters in interstate commerce on the ground that the manufacturer had produced the sweaters in violation of FLSA's minimum wage provisions. In *Shultz v. Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971), the Fourth Circuit followed *Powell Knitting Mills* with little discussion but added an additional requirement "that there be no collusion between the manufacturer and his financier permitting the introduction into the market of goods produced in violation of the Act." *See also Dunlop v. Sportsmaster, Inc.*, 77 Lab. Cas. (CCH) ¶ 33,293 (E.D. Tenn. 1975).

In *Powell Knitting Mills, supra*, the Secretary of Labor appealed from a district court order vacating a temporary restraining order that the district court had issued against a manufacturer of sweaters and the manufacturer's factor. The vacated order prohibited the factor from selling certain sweaters that the factor had acquired when it foreclosed its lien. The manufacturer had not paid eighty-six of its employees wages totaling $8,425 for the weeks ending February 18, February 25, and March 5, 1966. Beginning September 2, 1965, the factor had made approximately $700,000 in cash advances to the manufacturer, secured by liens on the manufacturer's inventory and equipment. The factor filed financing statements. On March 8, 1966, the manufacturer ceased operations and made an assignment for the benefit of creditors. The factor foreclosed and the Secretary of Labor brought the action to enjoin the sale of certain sweaters which had been produced during the time when the manufacturer had not paid wages.

The Second Circuit acknowledged that "[u]nder a literal, or, as Judge Zavatt called it, 'wooden' reading of the Act, the government would be entitled to an injunc-

tion." *Id.* at 732. The court of appeals recognized that one purpose of the FLSA's "hot goods" provision "was to prevent adverse competitive effects on those who comply with the Act." *Id.* at 733. The Second Circuit, however, stated that "[h]ere there can be no connection between the asserted violation and any effects on competition." *Id.* Although the court also recognized that another purpose of the "hot goods" provision was to assure that "wage earners would be paid," the court "[found] it hard to believe that Congress contemplated that the foreclosing creditor would have to pay the wage earners to avoid § 15." *Id.* The court observed that "restraining the sale in interstate commerce (until the wage claims were paid) comes close to giving such wage claims a priority over secured creditors contrary to the scheme of the Bankruptcy Act." *Id. See* 11 U.S.C. § 507. The court concluded:

> The purpose of forcing payment of wages should not apply to the creditor who advanced funds long before the default in wages, and who merely forecloses his lien, at least where the value of the goods acquired does not exceed the debt left unpaid.

Id. Accordingly, the Second Circuit affirmed the district court order vacating the temporary restraining order.

Although we are reluctant to create an intercircuit conflict, we cannot agree with the Second Circuit's "judicially created exception."[8] The Second Circuit's reasoning con-

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[8] Although twenty years have elapsed since the Second Circuit's decision, we do not think that the "judicially created exception" has become so well-settled as to preclude this Court from reexamining the Second Circuit's reasoning. *Contra Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 n.10 (1983) (courts had consistently recognized an implied cause of action under Rule 10b-5 for more than thirty-five years). Even though the Fourth Circuit and the United States District Court for the Eastern District of Tennessee, until one of the cases on appeal, followed *Powell Knitting Mills*, the two District Courts below and the United States District Court

flicts with the Supreme Court's interpretation of the purposes of the FLSA in *United States v. Darby, supra.* Congress does not want "hot goods" to taint the channels of interstate commerce. Furthermore, the "hot goods" in this case will compete with goods produced in conformity with the FLSA's minimum wage and overtime provisions if Citicorp places the goods in interstate commerce. The FLSA protects manufacturers who comply with the minimum wage and overtime provisions by keeping "hot goods" out of interstate commerce.[9] Our holding does not change the priorities in bankruptcy. Citicorp "owns" the goods. The "hot goods" provision merely prevents Citicorp from shipping, delivering or selling the goods in interstate commerce. Finally, the equities of the situation balance somewhere between Citicorp and the employees. Although Citicorp provided the capital and the materials for the production of the goods, that does not dictate that Citicorp should receive the benefits of the employee's labor during the three weeks which they worked on the goods but were not paid.

Congress has created only two exceptions—one for common carriers and one for good faith purchasers—to the broad scope of 29 U.S.C. § 215(a)(1), which otherwise applies to "any person."[10] Citicorp definitely does not

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for the Western District of Kentucky have refused to follow the "judicially created exception." *See also Brock v. Kentucky Ridge Mining Co., Inc.*, No. 85-0180 0(M) (W.D. Ky. Oct. 11, 1985).

[9] The dissenting opinion correctly notes that Citicorp has already sold the goods in question on the condition that it place the proceeds in escrow pending final resolution of this controversy. The dissent claims that "[t]he practical effect of the majority's decision is not to remove any tainted goods from competition . . . ." Citicorp, however, has effectively removed the "taint" from the goods by agreeing to pay the statutorily required wages if this Court holds that 29 U.S.C. § 15(a)(1) applies to secured creditors.

[10] We note that the legislative history of the FLSA does not conclusively indicate whether Congress intended the "hot goods" provision to apply to secured creditors. Although the Senate Bill

qualify as a common carrier. Citicorp has not raised the issue whether it could qualify as a good faith purchaser. We do observe, however, that although the extension of credit might qualify as a "purchase," Citicorp does not

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contained a provision that would have allowed a Labor Standards Board to exempt goods from the prohibition against interstate shipment if every person having a "substantial proprietary interest" in the goods could satisfy the Board that they had no reason to believe that any substandard condition existed in the production of the goods, the provision appeared in a reparation section. *See* H. Rep. No. 2738, 75th Cong., 3d Sess. 20 (1938). The exemption accordingly required that every employer having a proprietary interest in the goods who failed to maintain the required wage or hour standard to provide for the payment of reparation. The Senate Bill contained a separate section prohibiting the shipment of goods produced under substandard labor conditions. *Id.* at 17. Another section in the Senate Bill contained an exception to the prohibition against the interstate shipment of "substandard goods" for common carriers. *Id.* at 20. The House Amendment also prohibited the shipment of "substandard goods" in interstate commerce but also contained an exception for common carriers in the regular course of business. *Id.* at 26. The Conference Agreement adopted a version that closely followed the corresponding section of the House Amendment. *Id.* at 33.

In the Fair Labor Standards Amendments of 1949, Congress added an exception for "good faith purchasers" of goods produced in violation of the FLSA. The Conference Report stated:

> This [exception] protects an innocent purchaser from an unwitting violation and also protects him from having goods which he has purchased in good faith ordered to be withheld from shipment in commerce by a "hot goods" injunction. An affirmative duty is imposed upon him to assure himself that the goods in question were produced in compliance with the act, and he must have secured written assurance to that effect from the producer of the goods. The requirement that he must have made the purchase in good faith is comparable to similar requirements imposed on purchasers in other fields of law, and is to be subjected to the test of what a reasonable, prudent man, acting with due diligence, would have done in the circumstances.

Conf. R. No. 1453, 81st Cong., 1st Sess., *reprinted in*, 1949 U.S. Code Cong. & Ad. News 2241, 2271.

qualify as a "good faith purchaser" because Citicorp did not rely "on written assurance from the producer that the goods were produced in compliance with the requirements of [the FLSA]."[11] 29 U.S.C. § 215(a)(1). We agree that Congress never directly considered the question whether the "hot goods" provision applies to secured creditors. Nevertheless, Citicorp should not be in a better position as a secured creditor, for which Congress has not created an exception than as a "good faith purchaser," for which Congress specifically added an exception. Consequently, we conclude that *Powell Knitting Mills* created an exception for secured creditors that Congress did not and has not deemed appropriate. We, therefore, reject the reasoning in *Powell Knitting Mills* and hold that 29 U.S.C. § 215(a)(1) applies to secured creditors.

Accordingly, we affirm the orders of the District Courts granting the preliminary injunctions enjoining Citicorp from placing the goods in interstate commerce.

[11] Although the predecessor of Ely warranted, in the financing agreement, that it would "[c]omply with all laws, statutes, regulations and ordinances of any governmental entity," that representation does not amount to written assurance "that the goods *were* produced in compliance with the requirements of [the FLSA]."

ENGEL, Circuit Judge, dissenting. I respectfully dissent. I would follow the lead of the Second Circuit in *Wirtz v. Powell Knitting Mills, Inc.*, 360 F.2d 730 (2nd Cir. 1966), and of the Fourth Circuit in *Schultz v. Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971), and reverse.

If we were writing upon a clean slate, the majority opinion, in adopting a literal interpretation of the Fair Labor Standards Act, would have considerable appeal for the term "any person" is indeed broad and has been carefully defined by Congress, as the majority opinion observes. Beyond that, there is little to be said for the construction here mandated.

The evils foreseen and sought to be corrected by the Congress in enacting the "hot goods" provisions to the FLSA were twofold. Congress sought to improve working conditions by eliminating the incentive to manufacture goods at substandard wages and substandard hours; Congress also sought to prevent the injurious effect on trade that resulted when such goods were placed in interstate commerce in competition against goods that were manufactured in compliance with the FLSA. *See United States v. Darby*, 312 U.S. 100, 109-10 (1941). To accomplish these goals, Congress took the profit and, hence, the incentive out of such practices by making it unlawful to place into interstate commerce goods that were manufactured in noncompliance with the minimum wage and hour provisions of the FLSA. This much is clear.

In my opinion, however, an employer's inability to pay wages at all due to insolvency was not the target of the Act, at least where, as here, the employer is not otherwise shown to have been in noncompliance with the minimum wage and hour requirements of the statute. The problem here does not seem to have been an employer's unwillingness to comply with the Act, but instead an inability to pay any wages at all due to financial distress. Charac-

terizing the government's literal reading of the Act as "wooden," the Second Circuit observed in a similar situation, and correctly in my opinion, that "[o]ne purpose of making the sale illegal was to prevent the adverse competitive effects on those who comply with the Act. Here there can be no connection between the asserted violation and any effects on competition." *Wirtz v. Powell Knitting Mills Co.*, 360 F.2d 730, 733 (2nd Cir. 1966). It is just as reasonable to assume that perhaps one reason for the company's difficulty was its own previous compliance with the Act in the face of noncompliance by its competitors. No one has suggested that Congress, in passing the Fair Labor Standards Act, was seeking to tighten up the credit risks of producers of goods who may have otherwise been producing them in compliance with law but found themselves in financial difficulties. While imposing such risks upon lenders, as here, might hasten the demise of an insolvent company and thus avoid some loss to the wage earners who could not be paid at the end, the advantage of protecting otherwise valid security interests might equally have given the company precious time in which to recover from its straitened circumstances and thus to have provided employment at lawful wages longer.

The practical effect of the majority's decision is not to remove any tainted goods from competition for, as happened here, almost always the result will be that the goods are sold, if not in foreclosure, then in bankruptcy, or by other attaching creditors.[1] As here, the goods will go out in the market, but whether they are sold for competitively destructive prices will not depend on the cost

[1] The record discloses that an agreement was made in the district court whereby the goods were in fact released on condition that Citicorp place the proceeds of the sale in a separate account pending final resolution of this matter. Citicorp was therefore free and expected to dispose of these goods and, thus, to introduce them into interstate commerce to compete against those goods that were presumably manufactured in compliance with the Act.

of their production but upon the manner of their sale in any event. The real effect of the majority's interpretation is simply to create a judicial lien superior to the otherwise lawful lien which Citicorp possessed in the goods. In my view, this kind of pressure is the only motivation in the government in its present construction of the Act. Had it intended to create a federal lien law, Congress no doubt could have done so, but it did not. State laws governing creditors' rights, state laws protecting employees from non-payment of wages and bankruptcy laws generally, provide a great deal of relief for the protection of employees of defunct and insolvent corporations. It seems to me that in this special area of concern, the operation of these more traditional sources of law was intended by Congress to be sufficient. It is my opinion, therefore, that under a common sense application of section (15) (a) (1), Congress was looking instead at application of the Act in the course of the ongoing production of goods and not at the situation obtaining here and in the like cases in the Second and Fourth Circuits.

Even were I to agree with the majority here, I would still be reluctant to depart from a construction of the Act which has been in effect in the Second Circuit for twenty years and in the Fourth Circuit for nearly fifteen years. The need for a uniform national construction of the Act is obvious. Adherence to the existing interpretation, while expressing disagreement with it, could highlight the dispute should certiorari be sought, but without in the meanwhile creating a conflict in the circuits. While I do not argue in favor of any new rule respecting standards for avoiding intercircuit conflicts, we cannot be unaware that the resolution of intercircuit conflicts places a heavy burden upon the limited resources of the Supreme Court.[2]

[2] *See generally* Burger, *The Time is Now for the Intercircuit Panel*, 71 A.B.A.J. 86 (1985); Burger, *Annual Report on the State of the Judiciary*, 69 A.B.A.J. 442 (1983); Carrington, *Crowded Dockets and the Courts of Appeals: The Threat to the Function of*

Until there is a resolution of the problem, I would prefer to accept the judgment of other circuits where they have uniformly held to one construction over a long period of time, at least where I do not have an abiding and serious disagreement with the construction already in effect.

Review and the National Law, 82 Harv. L. Rev. 542, 596 (1969); *see also* Wallace, *Nature and Extent of Intercircuit Conflicts: A Solution Needed for a Mountain or a Molehill?* 71 Calif. L. Rev. 913 (1983).

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 85-5249/5252

WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
Plaintiff-Appellee,
v.

ELY GROUP, INC., ROCKFORD TEXTILE MILLS, INC.,
ELY & WALKER, INC.,
Defendants,
CITICORP INDUSTRIAL CREDIT, INC.,
Defendant-Appellant.

[Filed April 23, 1986]

Before: ENGEL, KENNEDY and RYAN, Circuit Judges.

JUDGMENT

ON APPEAL from the United States District Courts for the Eastern and Western Districts of Tennessee.

THIS CAUSE came on to be heard on the record from the said District Courts and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the judgments of the said District Courts in this case be and the same are hereby affirmed.

It is further ordered that Plaintiff-Appellee recover from Defendant-Appellant the costs on appeal, as itemized below, and that execution therefor issue out of said District Courts, if necessary.

ENTERED BY ORDER OF THE COURT

JOHN P. HEHMAN
Clerk

/s/ John P. Hehman
Clerk

Issued as Mandate: 5/15/86

Costs: $168.00

UNITED STATES DISTRICT COURT
W.D. TENNESSEE W.D.

No. 85-2276H

FORD B. FORD, UNDER SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
Plaintiff,

v.

ELY GROUP, INC., ROCKFORD TEXTILE MILLS, INC.,
ELY & WALKER, INC., and
CITICORP INDUSTRIAL CREDIT, INC.,
Defendants.

March 28, 1985

ORDER GRANTING
PRELIMINARY INJUNCTION

HORTON, District Judge.

On March 21, 1985, this Court entered a temporary restraining order, upon application of the Under Secretary of Labor, United States Department of Labor, enjoining the defendants, Ely Group, Inc., Rockford Textile Mills, Inc., Ely & Walker, Inc., and Citicorp Industrial Credit, Inc., from transferring, releasing, disposing of or attempting to dispose of, liquidating, divesting, moving, allowing the removal of or attempt to remove from defendants' establishment in Memphis, Tennessee, or elsewhere, any raw products, materials, supplies, partially completed goods, finished goods, fixtures, machinery or other goods (as defined by Section 3(i) of the FLSA) then on said premises or elsewhere, and from disposing of or attempting to dispose of any other assets pending

a hearing on plaintiff's application for a preliminary injunction.

The Court conducted a hearing for a preliminary injunction, upon notice, on March 26, 1985, as specified in the temporary restraining order.

After a full hearing, the Court finds the following facts:

1) Ely Group Inc., a corporation doing business in Memphis, Tennessee, has been engaged in the manufacture, warehousing and distribution of hosiery, apparel, and other textiles and goods through its subsidiaries Rockford Textiles, Inc., and Ely & Walker, Inc.

2) Citicorp Industrial Credit, Inc. (Citicorp) has been engaged in the business of funding the operational needs of Ely Group, Inc. and its subsidiaries, pursuant to a Financing Agreement, as amended, dated December 14, 1983 (Ex. 2).

3) Citicorp funded on a daily basis a zero balance bank account for Ely Group, Inc. Ely Group, Inc., (Ely) was requested to notify Citicorp each day as they obtained information from the banks that checks had cleared and Citicorp transferred funds by wire daily to meet the banking needs of Ely Group, Inc. Payments by customers of Ely Group, Inc., were made to Citicorp through a lock box system, a control system insuring that the money owed by Ely Group would flow back to the creditor Citicorp. While there is no evidence of collusion between officials of Citicorp and Ely Group, Inc., the evidence does show that Citicorp knew it was funding the payroll of Ely Group, Inc., and when this funding ceased Ely could not meet its payroll obligations to its employees.

4) Citicorp perfected its security interest in all inventory, accounts receivable, and other assets of Ely Group, Inc. by filing for recordation all appropriate documents in the proper counties of Tennessee and with the Secre-

tary of State for the State of Tennessee. Citicorp is a secured creditor of Ely Group, Inc., and is fully perfected upon the assets of Ely Group, Inc., (Ex. 4).

5) Citicorp conducted an ongoing monitoring system through auditors and/or field examiners who verified collateral upon which it made cash advances to Ely Group, Inc. These representatives of Citicorp conducted this monitoring on the premises of Ely Group, Inc., and its subsidiaries. They checked inventory, sales, credits and purchases to see if they were consistent with figures supplied to it by Ely Group, Inc. While these representatives did not verify wages paid to employees, they did check to see if Ely Group, Inc. paid all employee taxes.

6) During the Fall of 1984, Ely Group, Inc., started missing its sales projections. In February of 1985, the loan balance was about $9,500,000 and Ely Group, Inc., was losing money. Citicorp was concerned with why the inventory of Ely Group, Inc., was dropping precipitously while no sales were occurring.

7) On February 8, 1985, Citicorp delivered a letter to Ely Group, Inc., informing Ely it would no longer make cash advances and all loans due Citicorp by Ely Group, Inc., were due and payable.

8)On February 11, 1985, Ely Group, Inc., requested time to consult with a crisis management firm. This approach to the problems of Ely Group, Inc., did not prove worthwhile. Ely Group, Inc., was not generating cash but was actually consuming cash at the rate of $500,000.00 per week.

9) On February 19, 1985, Citicorp took possession of all assets of Ely Group, Inc., and the company ceased doing business on that date. Citicorp claims it is in a deficit position of $1,500,000 and is paying for warehousing of inventory it seized, guard service, insurance and utility bills. Citicorp has collected $1,200,000 in receivables at the Memphis location.

10) Hourly, bi-weekly and monthly employees have not been paid for their work which went into the manufacture and production of goods seized by Citicorp.

11) Approximately 300 hourly pay and bi-weekly pay employees at the Paragould, Arkansas, plant have not been paid for their work for a period of two to three weeks. Approximately 300 employees at the Rockford Textile Mills plants have not been paid for their work. In addition hourly, bi-weekly, monthly pay and executive employees who worked in the Memphis offices and warehouse remain unpaid.

12) While Citicorp argued that the entry of a preliminary injunction in this case will affect employment opportunities for Memphis workers at Ely Group, Inc., the evidence shows no future employment opportunities are contemplated for the Memphis operations of Ely Group, Inc. Instead, the proof shows Citicorp has negotiated a possible sale of a major part of the assets of Ely Group, Inc., and for plans to transfer inventory it has foreclosed upon from the Memphis warehouse facilities to Nashville, Tennessee and that transfer is imminent.

13) Representatives of the United States Department of Labor informed an attorney for Citicorp that goods had been produced by employees of Ely Group, Inc., and its subsidiaries, in violation of the Fair Labor Standards Act. Specifically, the Labor Department took the position these employees had not been paid according to the Act and the goods manufactured and produced during the period when employees were not paid could not be introduced into interstate commerce. The evidence is that Citicorp has shipped goods in interstate commerce since the facilities and subsidiaries of Ely Group, Inc., ceased operations and did so with knowledge that employees of the various entities had not been paid. Specifically there have been shipments to Walmart and Sears Roebuck & Company stores since February 19, 1985, of 1800 dozen shirts valued in excess of $100,000 and 2000 dozen shirts valued at about $7.60 per shirt.

14) Citicorp released a news items from its New York offices stating the inventory it had foreclosed upon pursuant to its perfected security interest would be sold to recoup some of its losses in its dealings with Ely Group, Inc., and subsidiaries.

The central issue in this case as stated by Citicorp is whether Section 15(a)(1) of the Fair Labor Standards Act applies to a secured creditor in possession who is fully perfected with top lien rights under state law. Can that secured creditor be forced by the Fair Labor Standards Act to take a back seat to unpaid workers despite its secured status? Stated another way, the issue is whether Citicorp, a secured creditor, who has foreclosed upon the assets of its debtor, Ely Group, Inc. and its subsidiaries, and is in possession of those assets, a substantial part of which were produced by unpaid workers allegedly in violation of the Fair Labor Standards Act, can be enjoined pursuant to Section 217, Title 29, United States Code from violating Section 215, Title 29, United States Code.

This Court rules Citicorp is subject to be enjoined and the Court finds it should grant a preliminary injunction enjoining Citicorp from disposing of any assets in its possession which were manufactured or produced by employees of Ely Group, Inc., and is subsidiaries, or any receivable collected for the sale of goods manufactured, produced or processed during the time workers were unpaid in violation of the Fair Labor Standards Act (FLSA).

Citicorp relies upon *Wirtz v. Powell Knitting Mills Co.*, 360 F.2d 730 (2d Cir. 1966), *Schultz v. Factors, Inc.*, 65 CCH Lab.Cas. 32, 487 (4th Cir.1971), and *Dunlop v. Sports-Master, Inc.*, 77 Lab.Cas. 33, 293 (E.D.Tenn. 1975). These cases hold the "hot goods" provision of FLSA does not apply to a secured creditor in possession of the assets of a debtor resulting from default of payment of loans previously advanced.

The Under Secretary of Labor maintains these cases apply an exception to the Fair Labor Standards Act (FLSA) which is not consistent with that Act as interpreted by the Supreme Court of the United States. The position of the Department of Labor, as stated in its brief filed March 21, 1985, is as follows:

The so-called "hot goods" provision of the Fair Labor Standards Act, 29 U.S.C. § 201, *et seq.*, is contained in § 15(a)(1) of the Act, 29 U.S.C. § 215(a)(1):

> After the expiration of one hundred and twenty days from the date of enactment of this Act, it shall be unlawful for any person—
>
> (1) to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 6 or section 7, or in violation of any regulation or order of the Secretary of Labor issued under section 14; except that no provision of this Act shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this Act shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of the Act, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful.

The basic purpose of the § 15(a)(1) prohibition, as the Supreme Court pointed out in *United States v. Darby*,

312 U.S. 100, 109-110, 61 S.Ct. 451, 454-55, 85 L.Ed. 609, "is to exclude from interstate commerce" goods produced under substandard labor conditions, which would compete unfairly with goods produced by complying employers, and which in their total effect might force complying employers out of business (*id.*, at 122, 61 S.Ct. at 461). This "evil" is the same whether the goods are sold and shipped in commerce by the manufacturer or by a foreclosing creditor. It is also immaterial that the tainted or "hot goods" held by the creditor are limited to the quantity in being at the time of the foreclosure. Thus, as the Supreme Court also pointed out in *Darby, supra*, "competition by a small part may affect the whole and . . . the total effect of the competition of many small producers may be great." *Id.* at 123, 61 S.Ct. at 461. An action to enforce the § 15(a) (1) prohibition is brought, not to compel the foreclosing creditor to pay the statutory wages or to put pressure on the defaulting producer to pay such wages, but to keep tainted goods from entering the channels of interstate commerce in competition with goods produced under the Act's standards.

Moreover, if foreclosing creditors are free to ship and sell tainted goods across state lines, the temptation to overextend credit to marginal producers is strong, as is the likelihood that such producers will become unable to meet their payrolls. The reason for this is that finance companies and institutions stand to reap financial gain by keeping such producers in business. A holding by this Court that creditors may not ship and sell in interstate commerce goods produced in violation of the Act will not only protect complying manufacturers from the unfair competition of such tainted goods, but, we submit, it will also discourage the type of commercial financing which leads to minimum wage and overtime violations.

This Court agrees with the position taken by the Department of Labor.

Section 15(a) (1) provides only two exceptions:

> no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and . . . any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful.

The Court finds neither applicable in the present case.

Further this Court concurs in the opinion of the United States District Court, Eastern District of Tennessee, Winchester Division, filed March 22, 1985. In that opinion, Judge Thomas G. Hull stated:

"No exception was specifically made by Congress in 29 U.S.C. § 215(a) (1) for a foreclosing creditor, and this Court refuses to read such an exception into the Act.

Secured creditors such as Citicorp take their security subject to the laws of the land. If such creditors have a security interest in property which was produced in violation of the provisions of the Fair Labor Standards Act, they retain their security interest, however, that interest is subject to the provisions of the Act. The Fair Labor Standards Act was enacted for the benefit and protection of the laborers and for the benefit and protection of employers who comply with the Act. As previously noted, goods produced in violation of the Act would compete unfairly with goods produced by complying employers. The market should not be flooded with goods produced in violation of the Act. In this instance, both the employees and

the secured creditor are innocent parties, the culprit being the manufacturer. However, in light of the purposes of the Act, it would be an unjust and harsh result for the creditor to get the benefit of the labor of the employees during the period of time they produced goods and were not paid as provided by the Act; a benefit which the creditor would not have without the employees labor."

Based upon all the evidence in the entire record in this case, the Court finds Citicorp Industrial Credit, Inc., a secured creditor in possession, imminently plans to ship goods in interstate commerce which were produced by employees of Ely Group, Inc., and its subsidiaries, Rockford Textile Mills, Inc., and Ely & Walker, Inc., and/or others, which were produced in violation of the Fair Labor Standards Act, 29 U.S.C. § 206, as amended, and the movement of these goods will result in the immediate and irreparable injury or damage to plaintiff and the public interest in that such shipment and movement of goods will make use of the channels and instrumentalities of interstate commerce to spread and perpetuate an unfair method of competition and interfere with the orderly and fair marketing of goods in commerce.

Plaintiff's application for a Preliminary Injunction is hereby ORDERED granted. It is further

ORDERED that defendants, their officers, agents, servants, employees and all persons in active concert or participation with them and all other persons who receive actual notice of this order by personal service or otherwise be, and they hereby are, enjoined from transferring, releasing, disposing of or attempting to dispose of, liquidating, divesting, moving, allowing the removal of or attempt to remove from defendants' establishment in Memphis, Tennessee, or elsewhere, any raw products, materials, supplies, partially completed goods, finished goods, or other goods now on said premises or elsewhere, and from disposing of or attempting to dispose of any

other assets which were produced during the period of time when employees of Ely Group, Inc., and its subsidiaries, were not paid for their labor as required by the Fair Labor Standards Act, specifically February 3, 1985, through February 19, 1985. It is further

ORDERED that this injunction covers accounts receivable collected by defendant Citicorp, and or any other defendant, on any goods produced by Ely Group, Inc., and its subsidiaries, during the same period of time, February 3, 1985, through February 19, 1985.

This order granting Preliminary Injunction shall remain in effect pending further costs of this Court or until the final disposition of this case.

UNITED STATES DISTRICT COURT
E.D. TENNESSEE
WINCHESTER DIVISION

No. CIV-4-85-26

RAYMOND J. DONOVAN, SECRETARY OF LABOR, UNITED STATES DEPARTMENT OF LABOR,
Plaintiff,

v.

ROCKFORD TEXTILE MILLS, INC., a Corporation; ELY GROUP, INC., a Corporation; and CITICORP INDUSTRIAL CREDIT, INC., a Corporation,
Defendants.

March 22, 1985

MEMORANDUM AND ORDER

HULL, District Judge.

On Friday, March 15, 1985, the plaintiff, Raymond J. Donovan, Secretary of Labor, United States Department of Labor, filed a motion for preliminary injunction and application for temporary restraining order, seeking, among other things, to enjoin the defendants, Rockford Textile Mills, Inc., Ely Group, Inc. and Citicorp Industrial Credit, Inc. (Citicorp), from violating certain sections of the Fair Labor Standards Act, specifically 29 U.S.C. §§ 206, 215(a)(1), and 215(a)(2). The Court denied the initial application for a temporary restraining order on March 15, 1985, and notified the parties that the Court would hold a show cause hearing on the motion for a preliminary injunction on March 20, 1985.[1] At the hearing on March 20, 1985, the Court granted a preliminary injunction in open court. This memorandum and order contains the Court's reasons for issuing the injunction and describes the acts sought to be restrained as required by Rule 65(d), Federal Rules of Civil Procedure.

It is undisputed that the defendant Ely Group, Inc. d/b/a Rockford Textile Mills, Inc. is a corporation having places of business and doing business in Warren County, Tennessee; that at all times pertinent hereto, it was engaged in the manufacture of hosiery at its manufacturing plant in McMinnville, Tennessee; and that it has been and is engaged in commerce or the production of goods for commerce within the meaning of 29 U.S.C. § 203(b) and (j). It is also undisputed that the defendant Citicorp is a secured creditor of co-defendant Ely Group, Inc. d/b/a Rockford Textile Mills, Inc., a defaulting debtor on funds advanced by Citicorp, which funds were secured by, among other things, Ely's inventory and accounts receivable. It was stipulated by the parties that Citicorp has a perfected security interest and has taken possession of the collateral. Also undisputed is the fact that Ely Group, Inc. d/b/a Rockford Textile Mills, Inc., has failed to meet three payrolls due to be paid their employees during the workweeks ending February 9, 16, and 23, 1985. Further, it is undisputed that operations at the McMinnville plant ceased on February 19, 1985, at which time employees were told to leave.

Title 29 U.S.C. § 206 requires that employers such as Ely Group, Inc. d/b/a Rockford Textile Mills, Inc., pay its employees an hourly wage of not less than $3.35 per hour. Since it is conceded by the parties that the employees at the McMinnville plant were not paid their wages during three (3) payroll weeks, it is clear that all

[1] Jurisdiction to hear this matter is conferred upon the Court by 29 U.S.C. 217.

hosiery manufactured during that time period (from February 3, 1985, through February 19, 1985) were produced in violation of the Fair Labor Standards Act.

Title 29 U.S.C. § 215(a) provides, in pertinent part, that:

> (a) . . . it shall be unlawful for any person (1) to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 206 or section 207 of this title, or in violation of any regulation or order of the Administrator issued under section 214 of this title; except that no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced on compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful; (2) to violate any of the provisions of section 206 or section 207 of this title, or any of the provisions of any regulation or order of the Administrator issued under section 214 of this title;
>
> . . . .

Title 29 U.S.C. § 217 accords the district court jurisdiction to issue orders restraining violations of 29 U.S.C. § 215.

The issue presented in this instance is whether Citicorp as a secured creditor in possession is subject to be enjoined pursuant to 29 U.S.C. § 217 from violating 29 U.S.C. § 215.

The defendant Citicorp urges the Court to adopt the rationale used by the Court of Appeals for the Second Circuit in *Wirtz v. Powell Knitting Mills Co.*, 360 F.2d 730 (2d Cir.1966) which held that the "hot goods" provision does not reach creditors foreclosing by valid process for nonpayment of funds previously advanced. This rationale was adopted by the Fourth Circuit in *Schultz v. Factors, Inc.*, 65 CCH Lab.Cas. 32, 487 (4th Cir.1971) with the proviso that there must be no evidence of "collusion between the manufacturer and his financier permitting the introduction into the market of goods produced in violation of the Act."[2] Apparently, there are no Supreme Court or Sixth Circuit cases on point with the instant case.

The plaintiff Secretary of Labor contends that 29 U.S.C. § 215(a) is intended by Congress as an absolute prohibition against the sale or shipment of "hot goods" by "any person", with only two exceptions: one for common carriers and one for innocent purchasers, as specifically provided under the Act. The Court agrees and thus does not address the issue of whether there was collusion between the defendants in this case.

One of the basic purposes of 29 U.S.C. § 215 is to exclude from interstate commerce goods produced under substandard labor conditions which would compete unfairly with goods produced by complying employers, and which in their total effect might force complying employers out of business. Title 29 U.S.C. § 215, as passed by Congress, specifically provides an exceptoin for common carriers in order "to prevent a case involving the constitutionality of the act from arising in a suit be-

[2] The rationale used in the *Powell* and *Factors* decisions was adopted by the district court in *Dunlop v. Sportsmaster, Inc.*, 77 Lab.Cas. 33, 293 (E.D.Tenn. 1975.)

tween a shipper and a common carrier, to which the Government was not a party, inasmuch as the common carrier has no interest in the issue of constitutionality, but only in its obligation to accept goods for transportation." (H.Rept. 2182, 75th Cong., 3d Session, 1938, p. 14). Under the original Act, all persons except carriers were subject to the prohibition in 29 U.S.C. § 215(a)(1). In 1949, however, Congress granted an exception for innocent purchasers who had no intent to deal in "hot goods." To invoke this exception, the purchaser has the affirmative duty to assure himself that the goods in question were produced in compliance with the Act. The purchaser must show that he acquired the goods (1) for value, (2) in good faith, (3) without notice of violations, and (4) after obtaining written assurances from the producer that the goods were produced in compliance with the Act's requirements.

No exception was specifically made by Congress in 29 U.S.C. § 215(a)(1) for a foreclosing creditor, and this Court refuses to read such an exception into the Act.

Secured creditors such as Citicorp take their security subject to the laws of the land. If such creditors have a security interest in property which was produced in violation of the provisions of the Fair Labor Standards Act, they retain their security interest, however, that interest is subject to the provisions of the Act. The Fair Labor Standards Act was enacted for the benefit and protection of the laborers and for the benefit and protection of employers who comply with the Act. As previously noted, goods produced in violation of the Act would compete unfairly with goods produced by complying employers. The market should not be flooded with goods produced in violation of the Act. In this instance, both the employees and the secured creditor are innocent parties, the culprit being the manufacturer. However, in light of the purposes of the Act, it would be an unjust and harsh result for the creditor to get the benefit of the labor of the employees during the period of time they

produced goods and were not paid as provided by the Act; a benefit which the creditors would not have without the employees labor.

Upon consideration of the motion for a preliminary injunction filed herein, the supporting affidavits of Richard Corbin and Bob Woodward, and the stipulation of facts by the parties at the hearing, it appearing to the Court that there is reason to believe that shipments are being or are about to be made, by defendant Citicorp Industrial Credit, Inc., and/or others, of goods which were produced by employees of the defendants Ely Group, Inc., and Rockford Textile Mills, Inc., in violation of the Fair Labor Standards Act of 1938, 29 U.S.C. § 206, as amended, and since the movement of such goods in commerce will result in immediate and irreparable injury or damage to the plaintiff and the public interest, since such movemnent will make use of the channels and instrumentalities of commerce to perpetuate an unfair method of competition and interfere with the orderly and fair marketing of goods in commerce, it is

ORDERED that plaintiff's motion for a preliminary injunction be and the same hereby is granted, and it is further ORDERED that defendants, their officers, agents, servants, employees, all persons in active concert or participation with them and all other parties who receive actual notice of this order by personal service or otherwise be, and hereby are, enjoined from transferring, releasing, disposing of or attempting to dispose of, liquidating, divesting, removing, allowing the removal of, or attempt to remove from the premises of defendants' establishment in McMinnville, Tennessee, or elsewhere, any goods which were produced during the period of time from February 3, 1985, through February 19, 1985, in violation of 29 U.S.C. § 206, now on said premises or elsewhere and from disposing of or attempting to dispose of such goods.

This order shall remain in effect until final disposition of this case.

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Case No. 85-5252

WILLIAM E. BROCK, Secretary of Labor,
United States Department of Labor,
Plaintiff-Appellee,

v.

ELY GROUP, INC., ROCKFORD TEXTILE MILLS, INC.,
ELY & WALKER, INC.,
Defendants,

CITICORP INDUSTRIAL CREDIT, INC.,
Defendant-Appellant.

[Filed Aug. 27, 1985]

ORDER

On March 29, 1985, Defendant-Appellant Citicorp Industrial Credit, Inc. moved to stay the district court's Order of March 22, 1985, which order enjoined the Defendants herein from taking certain specified actions with respect to the goods, supplies and other assets of Defendant Ely Group, Inc., produced during the period February 3 through February 19, 1985.

The Court considered Citicorp's Motion, and granted it conditioned upon Citicorp's giving adequate security for the stay. Such security, proposed by Citicorp, consisted of placing all of the proceeds of sales of Ely's assets into a separate interest-bearing account.

On August 2, 1985, Citicorp moved to modify the Order of March 29 to provide that a balance of One Million Dollars ($1,000,000) be maintained in the designated account, which was opened in April, 1985.

The Court has considered Citicorp's Motion, and based upon it, the response filed by the Secretary, and the Hearing on this matter held August 21, 1985 and exhibits presented therein, hereby grants it with the proviso that One and One-Half Million Dollars ($1,500,000) be maintained in the account.

It is therefore ORDERED that this Court's Order of March 29, 1985, granting Citicorp's Motion for Stay Pending Appeal be modified to require that Citicorp maintain a balance of One and One-Half Million Dollars ($1,500,000) in a separate interest-bearing account, to remain in such account, along with accruing interest, pending further resolution of this matter, subject to the terms and conditions set forth in this Court's Order of March 29, 1985.

/s/ Robert B. Krupansky
ROBERT B. KRUPANSKY
Circuit Judge

§ 206. **Minimum wage**

Employees engaged in commerce; home workers in Puerto Rico and Virgin Islands; employees in American Samoa; seamen on American vessels; agricultural employees

(a) Every employer shall pay to each of his employees who in any workweek is engaged in commerce or in the production of goods for commerce, or is employed in an enterprise engaged in commerce or in the production of goods for commerce, wages at the following rates:

(1) not less than $2.65 an hour during the year beginning January 1, 1978, not less than $2.90 an hour during the year beginning January 1, 1979, not less than $3.10 an hour during the year beginning January 1, 1980, and not less than $3.35 an hour after December 31, 1980, except as otherwise provided in this section;

(2) if such employee is a home worker in Puerto Rico or the Virgin Islands, not less than the minimum piece rate prescribed by regulation or order; or, if no such minimum piece rate is in effect, any piece rate adopted by such employer which shall yield, to the proportion or class of employees prescribed by regulation or order, not less than the applicable minimum hourly wage rate. Such minimum piece rates or employer piece rates shall be commensurate with, and shall be paid in lieu of, the minimum hourly wage rate applicable under the provisions of this section. The Administrator, or his authorized representative, shall have power to make such regulations or orders as are necessary or appropriate to carry out any of the provisions of this paragraph, including the power without limiting the generality of the foregoing, to define any operation or occupation which is performed by such home work employees in Puerto Rico or the Virgin Islands; to establish minimum piece rates for any operation or occupation so de-

fined; to prescribe the method and procedure for ascertaining and promulgating minimum piece rates; to prescribe standards for employer piece rates, including the proportion or class of employees who shall receive not less than the minimum hourly wage rate; to define the term "home worker"; and to prescribe the conditions under which employers, agents, contractors, and subcontractors shall cause goods to be produced by home workers;

(3) if such employee is employed in American Samoa, in lieu of the rate or rates provided by this subsection or subsection (b) of this section, not less than the applicable rate established by the Secretary of Labor in accordance with recommendations of a special industry committee or committees which he shall appoint in the same manner and pursuant to the same provisions as are applicable to the special industry committees provided for Puerto Rico and the Virgin Islands by this chapter as amended from time to time. Each such committee shall have the same powers and duties and shall apply the same standards with respect to the application of the provisions of this chapter to employees employed in American Samoa as pertain to special industry committees established under section 205 of this title with respect to employees employed in Puerto Rico or the Virgin Islands. The minimum wage rate thus established shall not exceed the rate prescribed in paragraph (1) of this subsection;

(4) if such employee is employed as a seaman on an American vessel, not less than the rate which will provide to the employee, for the period covered by the wage payment, wages equal to compensation at the hourly rate prescribed by paragraph (1) of this subsection for all hours during such period when he was actually on duty (including periods aboard ship when

the employees was on watch or was, at the direction of a superior officer, performing work or standing by, but not including off-duty periods which are provided pursuant to the employment agreement); or

(5) if such employee is employed in agriculture, not less than the minimum wage rate in effect under paragraph (1) after December 31, 1977.

Additional applicability to employees pursuant to subsequent amendatory provisions

(b) Every employer shall pay to each of his employees (other than an employee to whom subsection (a)(5) of this section applies) who in any workweek is engaged in commerce or in the production of goods for commerce, or is employed in an enterprise engaged in commerce or in the production of goods for commerce, and who in such workweek is brought within the purview of this section by the amendment made to this chapter by the Fair Labor Standards Amendments of 1966, title IX of the Education Amendments of 1972, or the Fair Labor Standards Amendments of 1974, wages at the following rate: Effective after December 31, 1977, not less than the minimum wage rate in effect under subsection (a)(1) of this section.

Wage rates superseded by recommendation of special industry committee

(c)(1) The rate or rates provided by subsection (a)(1) of this section shall be superseded in the case of any employee in Puerto Rico or the Virgin Islands only for so long as and insofar as such employee is covered by a wage order (A) heretofore or hereafter issued by the Secretary pursuant to the recommendations of a special industry committee appointed pursuant to section 205 of this title, and (B) which prescribes a wage order rate which is less than the wage rate in effect under subsection (a)(1) of this section.

(2)(A) Each wage order rate under a wage order described in paragraph (1) which on December 31, 1977, is at least $2 an hour shall, except as provided in paragraph (3), be increased—

(i) effective January 1, 1978, by $0.25 an hour or by such greater amount as may be recommended by a special industry committee under section 208 of this title, and

(ii) effective January 1, 1979, and January 1 of each succeeding year, by $0.30 an hour or by such greater amount as may be so recommended by such a special industry committee.

(B) Each wage order rate under a wage order described in paragraph (1) which on December 31, 1977, is less than $2 an hour shall, except as provided in paragraph (3), be increased—

(i) effective January 1, 1978, by $0.20 an hour or by such greater amount as may be recommended by a special industry committee under section 208 of this title, and

(ii) effective January 1, 1979, and January 1 of each succeeding year—

(I) until such wage order rate is not less than $2.30 an hour, by $0.25 an hour or by such greater amount as may be so recommended by a special industry committee, and

(II) if such wage order rate is not less than $2.30 an hour, by $0.30 an hour or by such greater amount as may be so recommended by a special industry committee.

(C) In the case of any employee in agriculture who is covered by a wage order issued by the Secretary pursuant to the recommendations of a special industry committee appointed pursuant to section 205 of this title, to whom

the rate or rates prescribed by subsection (a)(5) of this section would otherwise apply, and whose hourly wage is increased above the wage rate prescribed by such wage order by a subsidy (or income supplement) paid, in whole or in part, by the government of Puerto Rico, the applicable increases prescribed by subparagraph (A) or (B) shall be applied to the sum of the wage rate in effect under such wage order and the amount by which the employee's hourly wage is increased by the subsidy (or income supplement) above the wage rate in effect under such wage order.

(3) If the wage rate of an employee is to be increased under this subsection to a wage rate which equals or is greater than the wage rate under subsection (a)(1) of this section which, but for paragraph (1) of this subsection, would be applicable to such employee, this subsection shall be inapplicable to such employee and the applicable rate under subsection (a)(1) of this section shall apply to such employee.

(4) Each minimum wage rate prescribed by or under paragraph (2) shall be in effect unless such minimum wage rate has been superseded by a wage order (issued by the Secretary pursuant to the recommendation of a special industry committee convened under section 208 of this title) fixing a higher minimum wage rate.

Prohibition of sex discrimination

(d)(1) No employer having employees subject to any provisions of this section shall discriminate, within any establishment in which such employees are employed, between employees on the basis of sex by paying wages to employees in such establishment at a rate less than the rate at which he pays wages to employees of the opposite sex in such establishment for equal work on jobs the performance of which requires equal skill, effort, and responsibility, and which are performed under similar working conditions, except where such payment is made

pursuant to (i) a seniority system; (ii) a merit system; (iii) a system which measures earnings by quantity or quality of production; or (iv) a differential based on any other factor other than sex: *Provided*, That an employer who is paying a wage rate differential in violation of this subsection shall not, in order to comply with the provisions of this subsection, reduce the wage rate of any employee.

(2) No labor organization, or its agents, representing employees of an employer having employees subject to any provisions of this section shall cause or attempt to cause such an employer to discriminate against an employee in violation of paragraph (1) of this subsection.

(3) For purposes of administration and enforcement, any amounts owing to any employee which have been withheld in violation of this subsection shall be deemed to be unpaid minimum wages or unpaid overtime compensation under this chapter.

(4) As used in this subsection, the term "labor organization" means any organization of any kind, or any agency or employee representation committee or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, rates of pay, hours of employment, or conditions of work.

Employees of employers providing contract services to United States

(e)(1) Notwithstanding the provisions of section 213 of this title (except subsections (a)(1) and (f) thereof), every employer providing any contract services (other than linen supply services) under a contract with the United States or any subcontract thereunder shall pay to each of his employees whose rate of pay is not governed by the Service Contract Act of 1965 or to whom subsection (a)(1) of this section is not applicable, wages at

rates not less than the rates provided for in subsection (b) of this section.

(2) Notwithstanding the provisions of section 213 of this title (except subsections (a)(1) and (f) thereof) and the provisions of the Service Contract Act of 1965, every employer in an establishment providing linen supply services to the United States under a contract with the United States or any subcontract thereunder shall pay to each of his employees in such establishment wages at rates not less than those prescribed in subsection (b) of this section, except that if more than 50 per centum of the gross annual dollar volume of sales made or business done by such establishment is derived from providing such linen supply services under any such contracts or subcontracts, such employer shall pay to each of his employees in such establishment wages at rates not less than those prescribed in subsection (a)(1) of this section.

Employees in domestic service

(f) Any employee—

(1) who in any workweek is employed in domestic service in a household shall be paid wages at a rate not less than the wage rate in effect under subsection (b) of this section unless such employee's compensation for such service would not because of section 209(g) of the Social Security Act constitute wages for the purposes of title II of such Act, or

(2) who in any workweek—

(A) is employed in domestic service in one or more households, and

(B) is so employed for more than 8 hours in the aggregate,

shall be paid wages for such employment in such workweek at a rate not less than the wage rate in effect under subsection (b) or this section.

§ 207. **Maximum hours**

(a) Employees engaged in interstate commerce; additional applicability to employees pursuant to subsequent amendatory provisions

(1) Except as otherwise provided in this section, no employer shall employ any of his employees who in any workweek is engaged in commerce or the production of goods for commerce, or is employed in an enterprise engaged in commerce or in the production of goods for commerce, for a workweek longer than forty hours unless such employee receives compensation for his employment in excess of the hours above specified at a rate not less than one and one-half times the regular rate at which he is employed.

(2) No employer shall employ any of his employees who in any workweek is engaged in commerce or in the production of goods for commerce, or is employed in an enterprise engaged in commerce or in the production of goods for commerce, and who in such workweek is brought within the purview of this subsection by the amendments made to this chapter by the Fair Labor Standards Amendments of 1966—

(A) for a workweek longer than forty-four hours during the first year from the effective date of the Fair Labor Standards Amendments of 1966,

(B) for a workweek longer than forty-two hours during the second year from such date, or

(C) for a workweek longer than forty hours after the expiration of the second year from such date,

unless such employee receives compensation for his employment in excess of the hours above specified at a rate not less than one and one-half times the regular rate at which he is employed.

(b) Employment pursuant to collective bargaining agreement; employment by independently owned and controlled local enterprise engaged in distribution of petroleum products

No employer shall be deemed to have violated subsection (a) of this section by employing any employee for a workweek in excess of that specified in such subsection without paying the compensation for overtime employment prescribed therein if such employee is so employed—

(1) in pursuance of an agreement, made as a result of collective bargaining by representatives of employees certified as bona fide by the National Labor Relations Board, which provides that no employee shall be employed more than one thousand and forty hours during any period of twenty-six consecutive weeks; or

(2) in pursuance of an agreement, made as a result of collective bargaining by representatives of employees certified as bona fide by the National Labor Relations Board, which provides that during a specified period of fifty-two consecutive weeks the employee shall be employed not more than two thousand two hundred and forty hours and shall be guaranteed not less than one thousand eight hundred and forty hours (or not less than forty-six weeks at the normal number of hours worked per week, but not less than thirty hours per week) and not more than two thousand and eighty hours of employment for which he shall receive compensation for all hours guaranteed or worked at rates not less than those applicable under the agreement to the work performed and for all hours in excess of the guaranty which are also in excess of the maximum workweek applicable to such employee under subsection (a) of this section or two thousand and eighty in such period at rates not less than one and one-half times the regular rate at which he is employed; or

(3) by an independently owned and controlled local enterprise (including an enterprise with more than one bulk storage establishment) engaged in the wholesale or bulk distribution of petroleum products if—

(A) the annual gross volume of sales of such enterprise is less than $1,000,000 exclusive of excise taxes,

(B) more than 75 per centum of such enterprise's annual dollar volume of sales is made within the State in which such enterprise is located, and

(C) not more than 25 per centum of the annual dollar volume of sales of such enterprise is to customers who are engaged in the bulk distribution of such products for resale.

and such employee receives compensation for employment in excess of forty hours in any workweek at a rate not less than one and one-half times the minimum wage rate applicable to him under section 206 of this title,

and if such employee receives compensation for employment in excess of twelve hours in any workday, or for employment in excess of fifty-six hours in any workweek, as the case may be, at a rate not less than one and one-half times the regular rate at which he is employed.

(c), (d) Repealed. Pub.L. 93-259, § 19(e), Apr. 8, 1974, 88 Stat. 66.

(e) Definition of "regular rate" of employment

As used in this section the "regular rate" at which an employee is employed shall be deemed to include all

remuneration for employment paid to, or on behalf of, the employee, but shall not be deemed to include—

(1) sums paid as gifts· payments in the nature of gifts made at Christmas time or on other special occasions, as a reward for service, the amounts of which are not measured by or dependent on hours worked, production, or efficiency;

(2) payments made for occasional periods when no work is performed due to vacation, holiday, illness, failure of the employer to provide sufficient work, or other similar cause; reasonable payments for traveling expenses, or other expenses, incurred by an employee in the furtherance of his employer's interests and properly reimbursable by the employer, and other similar payments to an employee which are not made as compensation for his hours of employment;

(3) Sums paid in recognition of services performed during a given period if either, (a) both the fact that payment is to be made and the amount of the payment are determined at the sole discretion of the employer at or near the end of the period and not pursuant to any prior contract, agreement, or promise causing the employee to expect such payments regularly; or (b) the payments are made pursuant to a bona fide profit-sharing plan or trust or bona fide thrift or savings plan, meeting the requirements of the Administrator set forth in appropriate regulations which he shall issue, having due regard among other relevant factors, to the extent to which the amounts paid to the employee are determined without regard to hours of work, production, or efficiency; or (c) the payments are talent fees (as such talent fees are defined and delimited by regulations of the Administrator) paid to performers, including announcers, on radio and television programs;

(4) contributions irrevocably made by an employer to a trustee or third person pursuant to a bona fide plan for providing old-age retirement, life, accident, or health insurance or similar benefits for employees;

(5) extra compensation provided by a premium rate paid for certain hours worked by the employee in any day or workweek because such hours are hours worked in excess of eight in a day or in excess of the maximum workweek applicable to such employee under subsection (a) of this section or in excess of the employer's normal working hours or regular working hours, as the case may be;

(6) extra compensation provided by a premium rate paid for work by the employee on Saturdays, Sundays, holidays, or regular days of rest, or on the sixth or seventh day of the workweek, where such premium rate is not less than one and one-half times the rate established in good faith for like work performed in nonovertime hours on other days; or

(7) extra compensation provided by a premium rate to the employee, in pursuance of an applicable employment contract or collective-bargaining agreement, for work outside of the hours established in good faith by the contract or agreement as the basic, normal, or regular workday (not exceeding eight hours) or workweek (not exceeding the maximum workweek applicable to such employee under subsection (a) of this section,[1] where such premium rate is not less than one and one-half times the rate established in good faith by the contract or agreement for like work performed during such workday or workweek.

(f) Employment necessitating irregular hours of work

No employer shall be deemed to have violated subsection (a) of this section by employing any employee for

a workweek in excess of the maximum workweek applicable to such employee under subsection (a) of this section if such employee is employed pursuant to a bona fide individual contract, or pursuant to an agreement made as a result of collective bargaining by representatives of employees, if the duties of such employee necessitate irregular hours of work, and the contract or agreement (1) specifies a regular rate of pay of not less than the minimum hourly rate provided in subsection (a) or (b) of section 206 of this title (whichever may be applicable) and compensation at not less than one and one-half times such rate for all hours worked in excess of such maximum workweek, and (2) provides a weekly guaranty of pay for not more than sixty hours based on the rates so specified.

(g) Employment at piece rates

No employer shall be deemed to have violated subsection (a) of this section by employing any employee for a workweek in excess of the maximum workweek applicable to such employee under such subsection if, pursuant to an agreement or understanding arrived at between the employer and the employee before performance of the work, the amount paid to the employee for the number of hours worked by him in such workweek in excess of the maximum workweek applicable to such employee under such subsection—

(1) in the case of an employee employed at piece rates, is computed at piece rates not less than one and one-half times the bona fide piece rates applicable to the same work when performed during nonovertime hours; or

(2) in the case of an employee performing two or more kinds of work for which different hourly or piece rates have been established, is computed at rates not less than one and one-half times such bona

fide rates applicable to the same work when performed during nonovertime hours; or

(3) is computed at a rate not less than one and one-half times the rate established by such agreement or understanding as the basic rate to be used in computing overtime compensation thereunder: *Provided*, That the rate so established shall be authorized by regulation by the Administrator as being substantially equivalent to the average hourly earnings of the employee, exclusive of overtime premiums, in the particular work over a representative period of time;

and if (i) the employee's average hourly earnings for the workweek exclusive of payments described in paragraphs (1) through (7) of subsection (e) of this section are not less than the minimum hourly rate required by applicable law, and (ii) extra overtime compensation is properly computed and paid on other forms of additional pay required to be included in computing the regular rate.

(h) Extra compensation creditble toward overtime compensation

Extra compensation paid as described in paragraphs (5), (6), and (7) of subsection (e) of this section shall be creditable toward overtime compensation payable pursuant to this section.

(i) Employment by retail or service establishment

No employer shall be deemed to have violated subsection (a) of this section by employing any employee of a retail or service establishment for a workweek in excess of the applicable workweek specified therein, if (1) the regular rate of pay of such employee is in excess of one and one-half times the minimum hourly rate applicable to him under section 206 of this title, and (2) more than half his compensation for a representative period (not less than one month) represents commission on goods or serv-

ices. In determining the proportion of compensation representing commissions, all earnings resulting from the application of a bona fide commission rate shall be deemed commission on goods or services without regard to whether the computed commissions exceed the draw or guarantee.

(j) Employment in hospital or establishment engaged in care of sick, aged or mentally ill

No employer engaged in the operation of a hospital or an establishment which is an institution primarily engaged in the care of the sick, the aged, or the mentally ill or defective who reside on the premises shall be deemed to have violated subsection (a) of this section if, pursuant to an agreement or understanding arrived at between the employer and the employee before performance of the work, a work period of fourteen consecutive days is accepted in lieu of the workweek of seven consecutive days for purposes of overtime computation and if, for his employment in excess of eight hours and any workday and in excess of eighty hours in such fourteen-day period, the employee receives compensation at a rate not less than one and one-half times the regular rate at which he is employed.

(k) Employment by public agency engaged in fire protection or law enforcement activities

No public agency shall be deemed to have violated subsection (a) of this section with respect to the employment of any employee in fire protection activities or any employee in law enforcement activities (including security personnel in correctional institutions) if—

(1) in a work period of 28 consecutive days the employee receives for tours of duty which in the aggregate exceed the lesser of (A) 216 hours, or (B) the average number of hours (as determined by the Secretary pursuant to section 6(c)(3) of the Fair

Labor Standards Amendments of 1974) in tours of duty of employees engaged in such activities in work periods of 28 consecutive days in calendar year 1975; or

(2) in the case of such an employee to whom a work period of at least 7 but less than 28 days applies, in his work period the employee receives for tours of duty which in the aggregate exceed a number of hours which bears the same ratio to the number of consecutive days in his work period as 216 hours (or if lower, the number of hours referred to in clause (B) of paragraph (1) bears to 28 days,

compensation at a rate not less than one and one-half times the regular rate at which he is employed.

(*l*) Employment in domestic service in one or more households

No employer shall employ any employee in domestic service in one or more households for a workweek longer than forty hours unless such employee receives compensation for such employment in accordance with subsection (a) of this section.

(m) Employment in tobacco industry

For a period or periods of not more than fourteen workweeks in the aggregate in any calendar year, any employer may employ any employee for a workweek in excess of that specified in subsection (a) of this section without paying the compensation for overtime employment prescribed in such subsection, if such employee—

(1) is employed by such employer—

(A) to provide services (including stripping and grading) necessary and incidental to the sale at auction of green leaf tobacco of type 11, 12, 13, 14, 21, 22, 23, 24, 31, 35, 36, or 37 (as

such types are defined by the Secretary of Agriculture), or in auction sale, handling, stemming, redrying, packing, and storing of such tobacco,

(B) in auction sale, buying, handling, sorting, grading, packing, or storing green leaf tobacco of type 32 (as such type is defined by the Secretary of Agriculture), or

(C) in auction sale, buying, handling, stripping, sorting, grading, sizing, packing, or stemming prior to packing, of perishable cigar leaf tobacco of type 41, 42, 43, 44, 45, 46, 51, 52, 53, 54, 55, 61, or 62 (as such types are defined by the Secretary of Agriculture); and

(2) receives for—

(A) such employment by such employer which is in excess of ten hours in any workday, and

(B) such employment by such employer which is in excess of forty-eight hours in any workweek,

compensation at a rate not less than one and one-half times the regular rate at which he is employed.

An employer who receives an exemption under this subsection shall not be eligible for any other exemption under this section.

(n) Employment by street, suburban or interurban electric railway, or local trolley or motorbus carrier

In the case of an employee of an employer engaged in the business of operating a street, suburban or interurban electric railway, or local trolley or motorbus carrier (regardless of whether or not such railway or carrier is public or private or operated for profit or not for profit), in determining the hours of employment of such an employee to which the rate prescribed by subsection

(a) of this section applies there shall be excluded the hours such employee was employed in charter activities by such employer if (1) the employee's employment in such activities was pursuant to an agreement or understanding with his employer arrived at before engaging in such employment, and (2) if employment in such activities is not part of such employee's regular employment.

(*o*) Compensatory time

(1) Employees of a public agency which is a State, a political subdivision of a State, or an interstate governmental agency may receive, in accordance with this subsection and in lieu of overtime compensation, compensatory time off at a rate not less than one and one-half hours for each hour of employment for which overtime compensation is required by this section.

(2) A public agency may provide compensatory time under paragraph (1) only—

(A) pursuant to—

(i) applicable provisions of a collective bargaining agreement, memorandum of understanding, or any other agreement between the public agency and representatives of such employees; or

(ii) in the case of employees not covered by subclause (i), an agreement or understanding arrived at between the employer and employee before the performance of the work; and

(B) if the employee has not accrued compensatory time in excess of the limit applicable to the employee prescribed by paragraph (3).

In the case of employees described in clause (A)(ii) hired prior to April 15, 1986, the regular practice in effect on April 15, 1986, with respect to compensatory time off for such employees in lieu of the receipt of overtime com-

pensation, shall constitute an agreement or understanding under such clause (A)(ii). Except as provided in the previous sentence, the provision of compensatory time off to such employees for hours worked after April 14, 1986, shall be in accordance with this subsection.

(3)(A) If the work of an employee for which compensatory time may be provided included work in a public safety activity, an emergency response activity, or a seasonal activity, the employee engaged in such work may accrue not more than 480 hours of compensatory time for hours worked after April 15, 1986. Any such employee who, after April 15, 1986, has accrued 480 hours or 240 hours, as the case may be, of compensatory time off shall, for additional overtime hours of work, be paid overtime compensation.

(B) If compensation is paid to an employee for accrued compensatory time off, such compensation shall be paid at the regular rate earned by the employee at the time the employee receives such paymnt.

(4) An employee who has accrued compensatory time off authorized to be provided under paragraph (1) shall, upon termination of employment, be paid for the unused compensatory time at a rate of compensation not less than—

(A) the average regular rate received by such employee during the last 3 years of the employee's employment, or

(B) the final regular rate received by such employee, whichever is higher [2]

(5) An employee of a public agency which is a State, political subdivision of a State, or an interstate governmental agency—

(A) who has accrued compensatory time off authorized to be provided under paragraph (1), and

(B) who has requested the use of such compensatory time,

shall be permitted by the employee's employer to use such time within a reasonable period after making the request if the use of the compensatory time does not unduly disrupt the operations of the public agency.

(6) For purposes of this subsection—

(A) the term "overtime compensation" means the compensation required by subsection (a), and

(B) the terms "compensatory time" and compensatory time off" means hours during which an employee is not working, which are not counted as hours worked during the applicable workweek or other work period for purposes of overtime compensation, and for which the employee is compensated at the employee's regular rate.

(p) Special detail work for fire protection and law enforcement employees; occasional or sporadic employment; substitution

(1) If an individual who is employed by a State, political subdivision of a State, or an interstate governmental agency in fire protection or law enforcement activities (including activities of security personnel in correctional institutions) and who, solely at such individual's option, agrees to be employed on a special detail by a separate or independent employer in fire protection, law enforcement, or related activities, the hours such individual was employed by such separate and independent employer shall be excluded by the public agency employing such individual in the calculation of the hours for which the employee is entitled to overtime compensation under this section if the public agency—

(A) requires that its employees engaged in fire protection, law enforcement, or security activities be

hired by a separate and independent employer to perform the special detail,

(B) facilitates the employment of such employees by a separate and independent employer, or

(C) otherwise affects the condition of employment of such employees by a separate and independent employer.

(2) If an employee of a public agency which is a State, political subdivision of a State, or an interstate governmental agency undertakes, on an occasional or sporadic basis and solely at the employee's option, part-time employment for the public agency which is in a different capacity from any capacity in which the employee is regularly employed with the public agency, the hours such employee was employed in performing the different employment shall be excluded by the public agency in the calculation of the hours for which the employee is entitled to overtime compensation under this section.

(3) If an individual who is employed in any capacity by a public agency which is a State, political subdivision of a State, or an interstate governmental agency, agrees, with the approval of the public agency and solely at the option of such individual, to substitute during scheduled work hours for another individual who is employed by such agency in the same capacity, the hours such employee worked as a substitute shall be excluded by the public agency in the calculation of the hours for which the employee is entitled to overtime compensation under this section.

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No. 86-88

In the Supreme Court of the United States

OCTOBER TERM, 1986

CITICORP INDUSTRIAL CREDIT, INC., PETITIONER

v.

WILLIAM E. BROCK, SECRETARY OF LABOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether a secured creditor that forecloses on collateral that was produced by its debtor under conditions that violated the minimum wage and overtime provisions of the Fair Labor Standards Act can be enjoined, as the debtor could have been, from introducing the tainted assets into interstate commerce.

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STATEMENT

1. Petitioner makes commercial loans to industrial borrowers (J.A. 148-149). On December 14, 1983, petitioner entered into a financing agreement with Qualitex Corporation, the corporate predecessor of a group of companies consisting of the Ely Group, Inc. ("Ely Group") and its subsidiaries Rockford Textile Mills, Inc. ("Rockford"), and Ely & Walker, Inc. ("Ely & Walker") (collectively "Ely") (Pet. App. 2a; see J.A. 343-411). Ely did business in Tennessee, manufacturing and warehousing textiles for distribu-

tion nationwide (Pet. App. 19a).[1] Petitioner agreed to lend Ely up to $11 million by transferring funds on a daily basis to Ely's so-called "zero balance bank account" to meet Ely's daily operating expenses (*id.* at 2a & n.1). The collateral securing the loan included, among other things, Ely's inventory (*id.* at 2a; J.A. 356-357).

The financing agreement obligated Ely to provide petitioner with daily, weekly, and monthly financial reports (Pet. App. 2a-3a). Petitioner sent its representatives to Ely's premises to monitor Ely's inventory, sales, credits, and purchases (*id.* at 20a). Although it did not verify that wages were paid to Ely's employees, petitioner checked payroll records to determine whether Ely paid employee taxes (*ibid.*).

Ely's sales started falling below projections in the fall of 1984, and Ely stopped reporting to petitioner in January 1985 (Pet. App. 20a). By early February 1985, Ely's loan balance had increased to approximately $9,500,000 (*id.* at 3a), and Ely had defaulted on certain obligations under the financing agreement (*ibid.*). Petitioner last advanced funds to Ely on February 8, 1985 (*ibid.*). On February 11, 1985, petitioner terminated the financing agreement and demanded payment in full of Ely's obligations (*id.* at 20a; J.A. 300-301, 412-413). Ely's employees, many of whom were working on rush orders of seasonal clothing for three large retail chains (see J.A. 274-280), were not informed of this action. They continued working until February 19, 1985, when petitioner foreclosed and took possession of the collateral and Ely ceased operations (Pet. App. 3a). Petitioner's representatives remained on Ely's premises through that date, monitoring Ely's activities (J.A. 191, 192, 214, 215, 230, 277, 278).

[1] Rockford manufactured hosiery at a plant in McMinnville, Tennessee (Pet. App. 29a). Ely & Walker manufactured clothing in Paragould, Arkansas, and in Memphis, Tennessee, where it also operated a warehouse (*id.* at 19a, 21a).

2. Following the plant closings, the Wage and Hour Division of the Department of Labor began an investigation to determine whether Ely's employees had been paid in accordance with the Fair Labor Standards Act of 1938 ("FLSA" or "Act"), 29 U.S.C. 201 *et seq.* (see J.A. 17-18, 260, 281). The investigation revealed that Ely had failed to pay its employees for various periods dating from January 27, 1985, to February 19, 1985 (Pet. App. 3a). Under those circumstances, Ely, had it remained in possession of the collateral, would have been prohibited by Section 15(a)(1) of the FLSA, 29 U.S.C. 215(a)(1), from placing in interstate commerce any goods produced by its unpaid employees.

The Department of Labor investigators learned that petitioner had issued a press release stating its intention to sell the collateral on which it had foreclosed under the financing agreement (Pet. App. 22a), and that it had actually shipped a portion of Ely's goods interstate with knowledge that the Ely employees had not been paid (*id.* at 21a). On March 15, 1985, and March 21, 1985, the Secretary accordingly brought separate but related actions against Ely and petitioner in the United States District Courts for the Eastern and Western Districts of Tennessee. The Secretary alleged actual and potential violations of Section 15(a)(1) of the FLSA and moved for temporary restraining orders and preliminary injunctions prohibiting Ely and petitioner from placing in interstate commerce goods produced from February 3 through February 19, 1985 (Pet. App. 3a-4a). Both

courts subsequently entered the preliminary injunctions (*id.* at 27a, 33a).

Both courts held that Section 15(a)(1)—which makes it unlawful for "any person" to ship in interstate commerce "any goods in the production of which any employee was employed in violation [of the FLSA minimum wage and overtime provisions]"—prohibited not only Ely but also petitioner from placing in interstate commerce goods produced in violation of the FLSA. The courts noted that the statute makes no exception for creditors who acquired these so-called "hot goods" through foreclosure, and the courts "refuse[d] to read such an exception into the Act." Pet. App. 32a; see *id.* at 25a.

Both courts reasoned that this straightforward reading of Section 15(a)(1) drew support from the statutory policy of excluding from interstate commerce "goods produced under substandard labor conditions, which would compete unfairly with goods produced by complying employers" (Pet. App. 24a; see *id.* at 31a). As the Western District court noted, "[t]his 'evil' is the same whether the goods are sold and shipped in commerce by the manufacturer or by a foreclosing creditor" (*id.* at 24a); "[m]oreover, if foreclosing creditors are free to ship and sell tainted goods across state lines, the temptation to overextend credit to marginal producers is strong, as is the likelihood that such producers will become unable to meet their payrolls" (*ibid.*).[2]

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[2] The court in the Western District expressly found that, while there was no evidence of collusion between petitioner and Ely, "the evidence does show that [petitioner] knew it was funding the payroll of Ely Group, Inc., and when this funding ceased Ely could not meet its payroll obligations to its employees" (Pet. App. 19a). In addition, the court found that petitioner had shipped goods in interstate commerce after Ely ceased operations "and did so with knowledge that employees of the various entities had not been paid" (*id.* at 21a). Specifically, the court found that petitioner had shipped 1800 dozen shirts valued in excess of $100,000 and 2000 dozen shirts valued at about $182,000 to Walmart and Sears, Roebuck & Company stores (*ibid.*). The court also noted that petitioner had negotiated a possible sale of a major part of Ely's assets and planned an imminent transfer of inventory from Ely & Walker's Memphis warehouse to Nashville, Tennessee (*ibid.*).

The district courts therefore concluded that "[s]ecured creditors such as [petitioner] take their security subject to the laws of the land. If such creditors have a security interest in property that was produced in violation of the provisions of the Fair Labor Standards Act, they retain their security interest"— but that interest "is subject to the provisions of the Act." Pet. App. 25a; *id.* at 32a.

3. A divided panel of the court of appeals affirmed (Pet. App. 1a-16a).[3] The court "follow[ed] the 'plain

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[3] On April 10, 1985, the United States District Court for the Eastern District of Tennessee granted petitioner's motion for a stay of the preliminary injunction pending appeal to permit the delivery and sale of inventory worth about $200,000, on the condition that petitioner place the proceeds of the sale in a separate interest-bearing account to be used to pay the wages of Ely's former employees at Rockford in the event of an ultimate decision that Section 15(a)(1) applies to petitioner (J.A. 104-105). The district court in the Western District of Tennessee denied a similar motion, but the court of appeals granted a stay on the same conditions on March 29, 1985 (Pet. App. 4a), to permit petitioner to sell Ely and Walker's assets as an ongoing business for approximately $2,300,000 (Appellant's Motion For Stay Pending Appeal 4). The court of appeals subsequently modified the stay to permit petitioner, which had paid more than $4.5 million into an interest-bearing escrow account, to withdraw all but $1.5 million dollars (Pet. App. 34a-35a).

language' of the statute" in "conclud[ing] that the phrase 'any person' applies to [petitioner], as a secured creditor" (*id.* at 7a (footnote omitted)). In reaching this conclusion, the court emphasized that "one of the reasons that Congress passed the FLSA was to exclude tainted goods from interstate commerce" and that "prohibiting secured creditors, such as [petitioner], from shipping 'hot goods' in interstate commerce furthers that Congressional intent" (*ibid.*). This result, the court reasoned, "does not change the priorities in bankruptcy. [Petitioner] 'owns' the goods. The 'hot goods' provision merely prevents [petitioner] from shipping, delivering or selling the goods in interstate commerce" (*id.* at 10a).

The court accordingly rejected the reasoning of *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730 (2d Cir. 1966), which had held that Section 15 (a)(1) is inapplicable to secured creditors who take possession of goods produced in violation of the FLSA. The court of appeals found the creation of such a judicial exception to the reach of Section 15(a)(1) inappropriate (Pet. App. 9a). The court also concluded that such an exception would be inconsistent with the congressional intention that hot goods not "taint the channels of interstate commerce" or "compete with goods produced in conformity with the FLSA's minimum wage and overtime provisions" (*id.* at 10a).[4]

[4] Judge Engel dissented (Pet. App. 13a-16a). He noted that "[i]f we were writing upon a clean slate, the majority opinion, in adopting a literal interpretation of the Fair Labor Standards Act, would have considerable appeal for the term 'any person' is indeed broad and has been carefully defined by Congress" (*id.* at 13a). In his view, however, under a "common sense application of section 15(a)(1), Congress was looking instead at application of the Act in the course of the ongoing production of goods and not at the situation obtaining here" (*id.* at 15a). He therefore would have followed the holding of *Powell Knitting Mills* (see Pet. App. 15a-16a).

ARGUMENT

The decision of the court of appeals is correct. Both the language and the purposes of Section 15(a)(1) indicate that foreclosing creditors such as petitioner should be barred, like the debtors on whom they have foreclosed, from shipping hot goods in interstate commerce. And the conflict in the circuits on this point alleged by petitioner is neither sufficiently fixed nor of sufficient importance to require consideration by this Court. Further review of the court of appeals' decision is accordingly not warranted.

1. a. The Fair Labor Standards Act of 1938 was intended "to exclude from interstate commerce goods produced * * * under conditions detrimental to the maintenance of the minimum standards of living necessary for health and general well-being; and to prevent the use of interstate commerce as the means of competition in the distribution of goods so produced." *United States* v. *Darby*, 312 U.S. 100, 109-110 (1941). See 29 U.S.C. 202(a). To achieve this purpose, Section 15(a)(1) prohibits "any person" from "transport[ing] * * * or sell[ing] in commerce * * * any goods in the production of which any employee was employed in violation of [the FLSA's minimum wage and overtime provisions, 29 U.S.C. 206, 207]." 29 U.S.C. 215(a)(1). Section 3(a) of the FLSA in turn expansively defines "person" to include "an individual, partnership, association, corporation, business trust, legal representative, or any organized group of persons." 29 U.S.C. 203(a). En-

tities like petitioner thus fall squarely within the language of Section 15(a)(1)—as both the dissenting judge below (see Pet. App. 13a) and the Second Circuit in *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730, 732 (1966), acknowledged.

Congress itself carefully considered the need for exceptions to the prohibition on shipment of hot goods by "any person." Section 15(a)(1) contains two explicit exceptions. The first, which was enacted with the original FLSA in 1938, exempts common carriers from the statutory restriction on the transportation of hot goods.[5] The second exception, added in 1949, exempts bona fide purchasers if, but only if, they can show that they acquired the goods for value, in good faith, without notice of FLSA violations, and after obtaining written assurances from the producer that the goods were produced in compliance with the Act; it imposes "[a]n affirmative duty * * * upon [the purchaser] to assure himself that the goods in question were produced in compliance with the Act." H.R. Rep. 1453, 81st Cong., 1st Sess. 31 (1949). See 29 C.F.R. 789.5. Given these precisely drawn exceptions, petitioner cannot plausibly suggest that an additional exception should be implied for the benefit of secured creditors. See generally *Andrus* v. *Glover Construction Co.*, 446 U.S. 608, 616-617 (1980). As the court of appeals observed, petitioner "should not be in a better position as a secured creditor, for which Congress has not created an exception[,] than as a 'good faith purchaser,' for which

[5] This exception was included in the statute to "prevent a case involving the constitutionality of the act from arising in a suit between a shipper and a common carrier" over the carrier's "obligation to accept goods for transportation." H.R. Rep. 2182, 75th Cong., 3d Sess. 14 (1938).

Congress specifically added an exception" (Pet. App. 12a).[6]

A literal reading of Section 15(a)(1) also accords with this Court's usual approach to the FLSA. "The Court has consistently construed the Act 'liberally to apply to the furthest reaches consistent with congressional direction,' * * * recognizing that broad coverage is essential to accomplish the goal of outlawing from interstate commerce goods produced under conditions that fall below minimum standards of decency." *Tony & Susan Alamo Foundation* v. *Secretary of Labor*, No. 83-1935 (Apr. 23, 1985), slip op. 6 (quoting *Mitchell* v. *Lublin, McGaughy & Associates*, 358 U.S. 207, 211 (1959)). The Court has explained that exemptions from the FLSA's requirements are appropriate only if "plainly and unmistakably within [the Act's] terms and spirit" (*Phillips Co.* v. *Walling*, 324 U.S. 490, 493 (1945)), and should not be "enlarge[d] by implication." *Addison* v. *Holly Hill Co.*, 322 U.S. 607, 618 (1944). See *Powell* v. *United States Cartridge Co.*, 339 U.S. 497, 517 (1950); *Arnold* v. *Ben Kanowsky, Inc.*, 361 U.S. 388, 392 (1960); *Mitchell* v. *Kentucky Finance Co.*, 359 U.S. 290, 295 (1959).

Indeed, notwithstanding petitioner's hints to the contrary (see Pet. 20-21), the Secretary of Labor has consistently maintained that Section 15(a)(1), like

[6] The fact that, as petitioner notes (Pet. 5), Ely's promised wage rates satisfied the requirements of the FLSA has no legal significance. The Act is concerned with the amounts employees are actually paid, and it is undisputed that Ely itself could not lawfully ship the goods in question until it paid its employees. The question in this case is whether that statutory prohibition followed the goods into the hands of Ely's creditor.

the other provisions of the Act, should be read broadly. The Secretary has brought successful actions under the provision against a range of persons who, like petitioner, were at least one step removed from the employer who committed the minimum wage or overtime violation. See, *e.g.*, *Advance Bag & Paper Co.* v. *United States*, 133 F.2d 449 (5th Cir. 1943) (manufacturer covered where producer of component materials violated the Act); *Wirtz* v. *Lone Star Steel Co.*, 405 F.2d 668, 670 (5th Cir. 1968) (mill owner covered where violation committed by independent contractor). See also *Walling* v. *Acosta*, 140 F.2d 892, 894 (1st Cir. 1944) (person need not be the employer who violated 15 U.S.C. 206 or 207 to be bound by Section 15(a)(1)).

b. The court of appeals' conclusion that Congress meant what it said when it applied Section 15(a)(1) to "any person" is clearly confirmed by the legislative history. The FLSA was enacted shortly after this Court's invalidation of a congressional delegation of power in *Schechter Poultry Corp.* v. *United States*, 295 U.S. 495 (1935). Especially because of that decision, the Act was drafted with as much precision as possible, with the aim of avoiding a delegation challenge. As the Senate Committee on Education and Labor explained, "[t]he committee has diligently endeavored to write in the law itself, the rules and legal prohibitions intended to accomplish the desired objectives * * * [t]he committee seeking thus to decide every question that calls for a decision by Congress on legislative policies." S. Rep. 884, 75th Cong., 1st Sess. 5 (1937).

The careful attention paid to the language of the Act by the drafters is particularly significant here, because Congress devoted considerable attention to

the question whether "innocent" purchasers of hot goods should be exempted from Section 15(a)(1)—ultimately rejecting a provision that would have lifted the ban on the movement of hot goods under certain circumstances. That proposed provision, contained in a bill that passed the Senate, would have permitted a Labor Standards Board to exempt goods from the reach of Section 15(a)(1) if the Board found that the persons with an interest in the goods had no reason to believe that any substandard labor condition existed in the production of such goods or that such exemption is necessary to prevent undue hardship or economic waste. S. 2475, 75th Cong., 1st Sess. § 21(d) (1937). This provision, however, did not appear in the bill that passed the House or in the final bill that emerged from conference. See H.R. Rep. 2738, 75th Cong., 3d Sess. 33 (1938). Congress thus deliberately declined to carve out an exception for persons who were not directly responsible for the violation of the Act.

c. The court of appeals' literal reading is also entirely consistent with the policy of the Act. This Court has explained that "the goal [of the Act is to] outlaw[] from interstate commerce goods produced under conditions that fall below minimum standards of decency." *Tony & Susan Alamo Foundation*, slip op. 6. The Act implements President Roosevelt's declaration that "[g]oods produced under conditions which do not meet rudimentary standards of decency should be regarded as contraband and ought not be allowed to pollute the channels of interstate trade." H.R. Doc. 255, 75th Cong., 1st Sess. 3 (1937). See *Darby*, 312 U.S. at 115.[7] The prospect that goods

[7] That the court of appeals permitted petitioner to sell the goods on the condition that it compensate the unpaid em-

produced under conditions that violate the Act will be barred from interstate commerce provides a strong incentive to employers to adhere to the Act's minimum wage and overtime provisions; it also removes the unfair competitive advantage enjoyed by sellers of cheaply produced hot goods. See *id.* at 109-110; 29 U.S.C. 202(a).

These purposes are furthered by the ruling below. Applying Section 15(a)(1) to petitioner obviously serves "to lessen * * * the distribution in commerce of goods produced under subnormal labor conditions." *Rutherford Food Corp.* v. *McComb*, 331 U.S. 722, 727 (1947). And it means that not only struggling employers like Ely, but also creditors that, like petitioner, closely oversee the operations of such employers are put on notice that failure to pay employees is not an acceptable (or profitable) means of cutting costs. Most important, it eliminates the financial advantages that creditors like petitioner would otherwise obtain as a direct result of the failure of debtors like Ely to comply with the Act: by liquidating finished goods rather than bulk raw materials, petitioner would benefit from what is still the unpaid labor of Ely's employees, and the reading of the statute for which petitioner contends would give creditors

ployees if Section 15(a)(1) is found applicable does not, as petitioner suggests (Pet. 6 n.7), undercut the court of appeals' recognition (see Pet. App. 7a) that the hot goods are contraband. By requiring petitioner to hold an amount equal to the value of the unpaid wages in escrow pending resolution of this case, the court "effectively removed the 'taint' from the goods" (*id.* at 10a n.9). In any event, petitioner may not invoke this practical accommodation, made at its request, permitting it to substitute cash for tangible collateral, as determinative of any legal issue in the case.

a direct incentive to encourage the continuation of the manufacturing operations under conditions where employees may not be paid.

2. a. Petitioner's principal argument against following the plain language of the FLSA is that the plain language of Section 15(a)(1) establishes a "secret" lien for employee wage claims that interferes with the rights established under otherwise applicable bankruptcy law (Pet. 8, 10-11). To begin with, that contention has no application in this case: Ely never filed for bankruptcy, and this case accordingly does not involve any conflict between Code-established priorities and the operation of the FLSA.[8]

[8] Petitioner is incorrect in asserting (Pet. 11-12, 15-16) that this case raises the possibility of a conflict between the reach of Section 15(a)(1) and "the intended operation of other federal statutes" (Pet. 11) or state insolvency laws (Pet. 12). The FLSA, as construed by the court of appeals, is plainly consistent with, for example, the Packers and Stockyards Act and the Perishable Agricultural Commodities Act. See *Ruckleshaus* v. *Monsanto Co.*, 467 U.S. 986, 1018 (1984). The Packers and Stockyards Act creates a trust in meat (and proceeds from its sale) in favor of all unpaid sellers of livestock (7 U.S.C. 196(b)), giving such sellers priority over secured lenders in bankruptcy (see *First State Bank* v. *Gotham Provision Co.*, 669 F.2d 1000 (5th Cir.), cert. denied, 459 U.S. 858 (1982)) and under the Uniform Commercial Code (see *Fillippo* v. *S. Bonaccurso & Sons, Inc.*, 466 F. Supp. 1008, 1022 (E.D. Pa. 1978)). The Perishable Agricultural Commodities Act (7 U.S.C. (Supp. II) 499e(c)), was patterned after the Packers and Stockyards Act and affords sellers of such commodities the same protection. See *In re Fresh Approach, Inc.*, 48 Bankr. 926 (Bankr. N.D. Tex. 1985). The FLSA, unlike those statutes, does not create a lien and therefore does not displace otherwise applicable lien priorities. Petitioner likewise has failed to demonstrate any conflict between Section 15(a)(1) and any state insolvency law that would require this Court to consider the question of pre-

More fundamentally, as the court of appeals correctly observed, "[the] holding [in this case] does not change the priorities in bankruptcy" (Pet App. 10a). Section 15(a)(1) imposes a specific restriction, grounded in public policy, on the use of certain goods. The court of appeals ruled only that the public policy restriction remains applicable to the goods when they pass to a foreclosing creditor. That ruling did not alter petitioner's rights in the collateral as against Ely, nor did it give Ely's employees any rights in the property.

The ruling below is consistent with the settled principle that a foreclosing creditor does not obtain greater rights in the collateral than his debtor had. It is undisputed that Ely failed to comply with the FLSA and therefore could not have shipped the goods in interstate commerce. Petitioner—which, the courts below found, knew it was funding Ely's payroll (Pet. App. 19a) and continued monitoring Ely's production even after the financing agreement was terminated—should not have expected to gain greater rights when it took possession of the property. Nor does a literal reading of the FLSA make the extension of credit unduly hazardous: lenders, including petitioner in this case, routinely monitor their borrowers' activities closely to ensure that the borrowers comply with both public law and their obligations to other creditors, lest a legal bar or a superior lien (for taxes, to a supplier, or to employees) bar the exercise of the lender's rights.

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emption. In any event, if Section 15(a)(1) were inconsistent with state law, as petitioner contends, it is readily apparent from the cases petitioner itself cites (Pet. 14 n.18) that the federal law would control. See, *e.g.*, *Philko Aviation, Inc.* v. *Shacket*, 462 U.S. 406, 410 (1983).

b. As the court below recognized, Section 15(a)(1) is part of the "laws of the land," reflecting a public policy to which, with specified exceptions, all interests in covered property are subordinated. An action by the Secretary for injunctive relief under Section 17 of the FLSA, 29 U.S.C. 217, therefore is "primarily directed to promote a strong public policy of protecting employers who pay a lawful wage" (*Brennan* v. *T & T Trucking, Inc.*, 396 F. Supp. 615, 618 (N.D. Okla. 1975)), and thus is "primarily in the public interest despite the fact that employees may be the ultimate beneficiaries." *Donovan* v. *University of Texas*, 643 F.2d 1201, 1208 (5th Cir. 1981). See *Darby*, 312 U.S. at 114; *Wirtz* v. *Jones*, 340 F.2d 901, 903 (5th Cir. 1965).[9]

The distinction between the enforcement of a statutory mandate reflecting public policy and the enforcement of creditors' rights is now expressly recognized by the Bankruptcy Code itself, in 11 U.S.C. 362(b)(4), which excepts exercises of a "governmental unit's police or regulatory power" from the automatic stay otherwise imposed by 11 U.S.C. (& Supp. II) 362(a)(1) on proceedings against a debtor to collect pre-petition debts. Under Section 362(b)(4), "where a governmental unit is suing a debtor to prevent or stop a violation of * * * police or regulatory

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[9] As an enforcement action brought to vindicate the public interest, a suit such as this one cannot be seen as an attempt to collect a debt or impose a lien, whatever the effects of such a suit on the secured creditor's ability to dispose of its property. See *University of Texas*, 643 F.2d at 1208; *Donovan* v. *Brown Equipment & Service Tools, Inc.*, 666 F.2d 148, 156-157 (5th Cir. 1982); *Jones*, 340 F.2d at 903; *Donovan* v. *TMC Industries, Ltd.*, 95 Lab. Cas. (CCH) ¶ 34,278, at 44,976 (N.D. Ga. 1982); *T & T Trucking*, 396 F. Supp. at 617-618.

laws, or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under the automatic stay." S. Rep. 95-989, 95th Cong., 2d Sess. 52 (1978).[10]

Relying on the broad public welfare purposes underlying the FLSA in general and Section 17 in particular, the district and bankruptcy courts uniformly have concluded that enforcement proceedings under Section 17 fall within the Section 362(b)(4) exception. See *TMC Industries*, 95 Lab. Cas. (CCH) ¶ 34,278 at 44,979-44,981; *Donovan* v. *Timbers of Woodstock Restaurant, Inc.*, 93 Lab. Cas. (CCH) ¶ 34,155, at 44,426 (N.D. Ill. 1981); *In re Tauscher*, 24 Wage & Hour Cas. (BNA) 1310, 1311-1312 (Bankr. E.D. Wis. 1981); cf. *T & T Trucking*, 396 F. Supp. at 618. As construed by the courts in these cases, the exception from the automatic stay provided by Section 362(b)(4) "permits the government to enforce its laws uniformly without regard to the debtor's position in the bankruptcy court." *TMC Industries*, 95 Lab. Cas. (CCH) ¶ 34,278, at 44,977. To the extent that an action authorized by Section 362(b)(4) affects any priority, then, it is "not a

[10] Because of 11 U.S.C. 362(b)(4), governmental authorities have been permitted to proceed with a wide variety of regulatory or police measures despite the pendency of bankruptcy proceedings. *E.g.*, *Penn Terra Ltd.* v. *Department of Environmental Resources*, 733 F.2d 267 (3d Cir. 1984) (injunction against debtor to correct violations of state environmental protection statutes); *Commodity Futures Trading Comm'n* v. *Incomco, Inc.*, 649 F.2d 128 (2d Cir. 1981) (providing Commodity Futures Trading Commission access to debtor's books and records on trading activities); *National Labor Relations Board* v. *Evans Plumbing Co.*, 639 F.2d 291 (5th Cir. 1981) (petition for reinstatement of discriminatorily discharged employees with backpay).

priority to proceeds from the estate, but a priority in terms of having access to any proper court to enforce laws that promote public health and welfare * * * The Fair Labor Standards Act clearly is such a law." *TMC Industries*, 95 Lab. Cas. (CCH) ¶ 34,278, at 44,981.

3. Petitioner also asserts that review is required to resolve a conflict between the decision below and the decisions of the Second and Fourth Circuits in *Wirtz* v. *Powell Knitting Mills Co.*, *supra*, and *Schultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971). While the decision of the court of appeals here is inconsistent with *Powell Knitting Mills*, this conflict is neither sufficiently fixed nor of sufficient importance to warrant consideration by the Court.

Prior to this litigation (and excluding the *Powell Knitting Mills* and *Factors* lawsuits), the issue involved here was addressed by the courts only twice, both times in districts in the Sixth Circuit. *Dunlop* v. *Sportsmasters, Inc.*, 77 Lab. Cas. (CCH) ¶ 33,293 (E.D. Tenn. 1975) (following *Powell Knitting Mills*); *Brock* v. *Kentucky Ridge Mining Co.*, C.A. No. 85-0180-O(M) (W.D. Ky. Oct. 11, 1985) rejecting the "judicially created exception" to Section 15(a)(1) used in that case).[11] Because actions to enforce

[11] The United States District Court for the Middle District of Tennessee recently granted a temporary restraining order enjoining both an employer and its secured creditor from moving hot goods in violation of Section 15(a)(1) of the FLSA. *Brock* v. *LTW Sportswear, Inc.*, C.A. No. 2-86-0075 (M.D. Tenn.). Secured creditors have intervened as defendants in at least two other Section 15(a)(1) enforcement actions that were settled after preliminary injunctions were issued. *Donovan* v. *Standard Forge & Axle Co., Inc.*, C.A. No. 84-T-13 74 N (M.D. Ala.) (dismissed Nov. 15, 1984); *Donovan* v. *Fabrics America, Inc.*, C.A. No. 82-245-S (M.D. Ala.) (dismissed Jan. 12, 1984). The preliminary injunction in *Stand-*

Section 15(a)(1) against secured creditors are brought with such infrequency, the resolution of the conflict here will not have a significant effect on the administration of the FLSA.

In any event, the panel in *Powell Knitting Mills* relied in part on the rationale that preventing a secured creditor from selling hot goods "comes close to giving * * * wage claims a priority over secured creditors contrary to the scheme of the Bankruptcy Act [of 1898]." 360 F.2d at 733. The Second Circuit has not had a chance to consider the vitality of this ruling in light of Section 362(b)(4) of the new Bankruptcy Code, in which Congress provided that exercises of the police power, presumably including enforcement actions under Section 17 of the FLSA, should proceed independently of bankruptcy proceedings. It therefore is unclear whether the Second Circuit would follow *Powell Knitting Mills* if it were again confronted with a question about the applicability of Section 15(a)(1) to secured creditors. Indeed, the panel in *Powell Knitting Mills* recognized that, "[u]nder a literal * * * reading of the [Fair Labor Standards] Act, the government would be entitled to an injunction." 360 F.2d at 732. In these circumstances, there is no reason to believe that intervention by this Court is necessary to resolve the disagreement among the courts of appeals.[12]

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ard Forge restrained both the secured creditor, which had intervened after the temporary restraining order was issued, and the employer. The creditor in *Fabrics America* was not enjoined.

[12] The Fourth Circuit in *Factors* adopted the *Powell Knitting Mills* rationale and, like the Second Circuit, has not had an opportunity to reconsider the issue in light of Section 362(b)(4) of the new Bankruptcy Code. The *Factors* court, moreover, indicated that the shipment of hot goods could be restrained when there was "collusion between the manufacturer and his financier permitting the introduction into the market of goods produced in violation of the Act." 65 Lab. Cas. (CCH) ¶ 32,487, at 44,732. Although the court did not explain what it meant by "collusion," it cited *Wirtz* v. *Lone Star Steel Co.*, 405 F.2d 668 (5th Cir. 1968). In that case, the court restrained the shipment of hot goods by a steel mill operator, finding that the operator could and should have known that its independent contractor had violated the FLSA's minimum wage requirements. 405 F.2d at 670. Here, petitioner "knew it was funding the payroll of Ely Group, Inc., and when this funding ceased Ely could not meet its payroll obligations to its employees" (Pet. App. 19a). Petitioner also knew as early as February 14, 1985, five days before its foreclosure resulted in the shutdown of Ely's operations, that Ely had defaulted on at least one payroll (J.A. 305-306). And petitioner shipped goods in interstate commerce "with knowledge that the employees of the various [Ely] entities had not been paid" (Pet. App. 21a). Given these circumstances, application of the *Factors* test to the record here would probably not have changed the outcome.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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(4)

No. 86-88

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

CITICORP INDUSTRIAL CREDIT, INC.,
Petitioner,

v.

WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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REPLY BRIEF

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REPLY BRIEF

The petition presents one fundamental question: whether, in enacting the "hot goods" provision of the Fair Labor Standards Act (29 U.S.C. § 15(a)(1)), Congress intended not only to provide a remedy against an employer's payment of substandard wages, but also to effect massive changes in otherwise applicable state and federal laws governing the relative priority of creditors' claims against insolvent debtors.

The Secretary cannot deny the clear conflict among the courts of appeals on the question presented, and his assertion (Resp. Br. 7) that the conflict is "neither sufficiently fixed nor of sufficient importance to warrant consideration by this Court" is wrong. The Secretary offers

no assurance that he will not use to considerable advantage the first appellate court endorsement of his novel reading of the FLSA; in fact, the Secretary's brief suggests that the Sixth Circuit victory will be used to press FLSA claims against secured creditors at every opportunity.[1] Moreover, none of the arguments raised in opposition to the petition warrants a departure from this Court's usual practice of reviewing acknowledged conflicts in the courts of appeals concerning significant issues that affect a broad range of interests.

1. Resolution of the conflict among the courts of appeals as to the scope of § 15(a)(1) of the FLSA is of immediate and substantial practical importance to the commercial finance industry. The consequences for commercial lenders of the existing uncertainty generated by the Sixth Circuit's holding in this case are described in the petition and at length in the *amicus* brief of the National Commercial Finance Association ("NCFA Br."). Pet. 10-11; NCFA Br. 4-9. The Secretary does not deny the likely impact of the Sixth Circuit's holding on the commercial finance industry; he ignores it.

Instead, the Secretary points to the absence of reported cases as evidence that the question presented is not sufficiently important to warrant review in this Court. Resp. Br. 17-18. As counsel for the Secretary explained in the courts below, however, the absence of reported cases is testament to the effectiveness of § 15(a)(1) as a club to coerce secured creditors to pay the wages of their debtors' employees (C.A. App. 66):

> "Your Honor, there's not much case law, as TRO's have been issued, usually, and after they are issued parties get together and pay everybody, and [the case] never goes any further than that."

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[1] *See generally* Brief of the National Commercial Finance Association as *Amicus Curiae* ("NCFA Br.") 5.

See NCFA Br. 6. In cross-examining one of Citicorp's officers in the district court, the Secretary's counsel went further, intimating that the question has arisen in "numerous cases . . . filed . . . in the last few years. . . . (C.A. App. 313).[2] See also Resp. Br. 17-18 n.11. Thus, far from supporting the Secretary's assertion that the question presented does not warrant review, the absence of reported cases suggests compelling reason for immediate review by this Court of the Secretary's improper use of § 15(a)(1) to force secured creditors to pay the wages of their insolvent debtors' employees.

Alternatively, the Secretary argues that the admitted conflict among the courts of appeals is not "sufficiently fixed" to warrant review in this Court. Resp. Br. 17-18. According to the Secretary, the Second Circuit someday might reconsider its 20-year old holding in *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730 (1966), because an irrelevant provision in the Bankruptcy Code now permits certain types of enforcement proceedings against a bankrupt.[3] The Secretary's argument is unpersuasive, at best. First, the holding in *Powell Knitting* rests on the court's analysis of the purpose of the FLSA and common sense, not any potential conflict with the provisions of the Bankruptcy Act, as it existed in 1966. Second, while there is always a theoretical possibility that a court may reconsider a prior decision, that bare possibility is hardly sufficient basis for tolerating a clear and significant conflict in the courts of appeals concerning the scope of a national statute. Third, the possibility that the Second Circuit—or perhaps the Sixth Circuit—may one day re-

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[2] C.A. App. 313 ("Are you aware that numerous cases have been filed throughout this country in the last few years involving 'hot goods' and secured creditors which have been resolved and have never been reported; you are not aware of that, are you?").

[3] The Bankruptcy Code provision is irrelevant because this case concerns the priority of creditors' claims, not whether an action may proceed. The provision on which the Secretary now relies played no role in the analysis of the Sixth Circuit or that of either of the district courts in this case.

consider their respective decisions does nothing to mitigate the immediate consequences to the commercial finance industry of the existing uncertainty. In fact, to the extent the Secretary's brief (Resp. Br. 17-18) reflects an intention to revisit the issue in the Second Circuit and the Fourth Circuit, there is even greater uncertainty for the commercial finance industry.

The Secretary's casual suggestion that "application of the [*Schultz* v. *Factors, Inc.* 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971)] test to the record here would probably not have changed the outcome" (Resp. Br. 19 n.12) is insupportable. The facts in this case and those in both *Powell Knitting* and *Factors* are indistinguishable. Contrary to the suggestions of the Secretary (*e.g.*, Resp. Br. 3, 4-5 n.2, 14, 18-19 n.12), there is no evidence of any wrongdoing by Citicorp, or anything that could be characterized as "collusion." As both district courts acknowledged, "the employees and the secured creditor [*i.e.*, Citicorp] are innocent parties. . . . (Pet. App. 25a-26a, 33a; see Pet. App. 10a). Citicorp did not make or control Ely's payroll decisions.[4] Until the Sixth Circuit's

[4] The Secretary suggests that "creditors . . . like [Citicorp] closely oversee the operations" of their debtors (Resp. Br. 12; *see id.* 2), and therefore control or should control the management of their debtors' businesses—particularly the payment of employee wages. That suggestion is incorrect, as a matter of fact, and moreover ignores commercial reality. There is a wide gulf between oversight and control, and there is no evidence of the latter in this case. As explained by the NCFA, a secured creditor's attempt to control its debtor's business would raise a "variety of serious business and legal problems" (NCFA Br. 9), including exposure to increased potential liability. Further, contrary to the Secretary's apparent assumption, "close" oversight by secured creditors will not avoid non-payment of employee wages. The creditor would become aware of its debtor's failure to pay employees only after the damage had been done; under the Sixth Circuit's holding, once the payroll is missed, the Secretary is entitled to an injunction preventing sale of collateral by a secured creditor. Finally, it is the propriety of using § 15(a)(1) to pressure secured creditors, whether to pay the wages of its debtor's employees or to police its debtor's payroll decisions, that is at issue.

decision in this case, every appellate court that had considered the issue had concluded that § 15(a)(1) imposed no obligation on a secured creditor to assure that its debtor's employees were paid before selling collateral.

2. As set out in the petition, the holding of the Sixth Circuit effectively establishes a federal lien or trust for employee-wage claims superior to earlier perfected security interests and other consensual, statutory, or judicial liens, contrary to state law. Pet. 14-16. The phrase "any person" is broad enough to include a secured creditor, but it is undisputed that "Congress never directly considered the question whether the hot goods provision applies to secured creditors" (Pet. App. 12a). Moreover, there is no evidence that, in enacting the FLSA, Congress intended wholesale displacement of state policy judgments concerning the priority of creditors' claims against insolvents. The sole purpose of the FLSA was to establish decent wages and hours for American workers. Thus, the critical dispute in this case is whether the general language of a federal statute addressing labor wage and hour standards is properly construed to preempt state law governing the priority of creditors' claims, without any evidence that Congress intended to do so. The Secretary responds that to the extent of any conflict "federal law would control" (Resp. Br. 14 n.8). Clearly-established principles of federalism require more respect for state legislation.

Absent persuasive evidence that Congress intended to displace state law governing the priorities of creditors of insolvent corporations, the general language of a federal statute should not be construed to have such an effect.[5] "[T]he principal means chosen by the Framers to ensure

[5] *See, e.g., Louisiana Public Service Commission* v. *FCC*, 106 S. Ct. 1890, 1899 (1986); *Philko Aviation, Inc.* v. *Shacket*, 462 U.S. 406, 409-411 & nn.2-4 (1983); *In the Matter of Gary Aircraft Corp.*, 681 F.2d 365, 368-372 (5th Cir. 1982), *cert. denied*, 462 U.S. 1131 (1983).

the role of the States in the federal system lies in the structure of the Federal Government itself."[6] When generally-worded provisions of a federal statute are construed to supersede state policy judgments—without any evidence of consideration by Congress—the safeguards for federalism inherent in the structure of the national government cannot "perform[] as intended" (*Garcia* v. *San Antonio*, 469 U.S. at 556).[7] "[T]he implications and limitations of our federal system constitute a major premise of all congressional legislation," and therefore Congress "will not be deemed to have significantly changed the federal-state balance . . . unless otherwise the purpose of the Act would be defeated."[8] The Secretary's effort in this case to satisfy the heavy burden of persuasion imposed by the "implications and limitations of our federal system" fails.[9]

[6] *Garcia* v. *San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 550 (1985); *see generally* H. Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 Colum. L. Rev. 543 (1954).

[7] Whatever doubt there may be as to whether those "safeguards" are sufficient, *see Garcia* v. *San Antonio*, 469 U.S. at 565-566 & n.9 (Powell, J., dissenting); *id.*, 469 U.S. at 584, 587 (O'Connor, J., dissenting), construing the general language of a federal statute to supersede state laws on matters of primarily local concern without evidence that Congress ever considered, much less intended such a result, renders those safeguards wholly ineffective.

[8] *Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2121 & nn.32-33 (1986) (plurality opinion); *see Kirschbaum Co.* v. *Walling*, 316 U.S. 517, 520-522 (1942).

[9] The potential conflict with other federal legislation created by the Sixth Circuit's construction of § 15(a)(1) is an additional reason for rejecting the court's conclusion. *See* Pet. 11-12. The Secretary flatly asserts (Resp. Br. 13 n.8) that there is no "possibility of conflict between the reach of Section 15(a)(1)" and other federal statutes or state statutes, apparently because "[t]he FLSA, unlike those statutes, does not create a lien." Nonetheless, he offers no explanation of how § 15(a)(1), as interpreted by the Sixth Circuit, could be applied in a case involving the Packers and Stockyards Act or the Perishable Agricultural Commodities Act, without frustrating Congress' manifest intent; nor does the Secretary explain how labeling the FLSA something other than a "lien" statute avoids the demonstrated conflict among the federal statutory schemes created by the Sixth Circuit's interpretation of the FLSA.

Contrary to the Secretary's argument (Resp. Br. 7-13), neither the language nor the purpose of the Act requires the result reached by the Sixth Circuit. Section 15(a)(1) provides a "strong incentive to employers to adhere to the Act's minimum wage and overtime provisions" (Resp. Br. 12), but Citicorp was not the offending employer and exercised no control over its debtor's payroll. Section 15(a)(1) also denies an employer "the unfair competitive advantage" of selling goods produced in violation of the Act. But Congress was concerned about the "unfair competitive advantage" of sellers of cheap goods because competition from such sellers would "exert downward pressure on wages" (*Tony & Susan Alamo Foundation* v. *Secretary of Labor*, 105 S. Ct. 1953, 1962 (1985)). Citicorp is not in the business of selling sweaters or hosiery, and therefore neither sought nor obtained any "competitive advantage" when it was forced to sell the collateral. Citicorp's only interest was in liquidating the collateral at the best price obtainable in the market in the hope of securing repayment of some part of its loans. A secured creditor's sale of collateral poses no danger of affecting wage rates. See Pet. 19-20.[10]

The focus of the FLSA was the wages and hours of employees of ongoing businesses, not the priority of creditors' claims against a failed business. Thus, whether § 15(a)(1) would have prevented Ely from shipping the inventory, as the Secretary asserts (Resp. Br. 9 n.6) is not conceded, but the far more difficult question presented in this case is whether § 15(a)(1) is properly invoked

[10] Further, in focusing on the exclusion of "contraband" from the channels of interstate commerce and ignoring Congress' reason for excluding such goods (*e.g.*, Resp. Br. 4, 6, 7, 9), the Secretary confuses the mechanism for enforcement with Congress' purpose.

against a secured creditor. As explained in the petition (Pet. 16-19), § 15(a)(1) was broadly worded to bring within its reach all employers in the chain of production and distribution to avoid circumvention, not to provide a mechanism for coercing an innocent creditor to pay the wages of its debtor's employees.[11] Neither the omission of the limited provision authorizing a Labor Standards Board to grant exemptions from § 15(a)(1) nor the 1949 amendment to § 15(a)(1) provides any support for the Secretary's position in this case. Since only the government was authorized to enforce § 15(a)(1), the proposed exemption authority was unnecessary. Pet. 16-17 n.25. The Secretary's suggestion (Resp. Br. 11) that in omitting this narrow provision, *without comment*, Congress intended to punish innocent parties who acquired "hot goods" in the ordinary course of business is wildly implausible. Similarly, as explained in the petition (Pet. 20 n.33), the 1949 amendment worked no change in the law and was adopted without controversy; it simply confirmed Congress' obvious intent in enacting § 15(a)(1) in 1938.

In sum, there is no evidence that, in 1938 or at any time thereafter, Congress actually considered creating a "secret" trust or lien for employee-wage claims superior to a perfected security interest in inventory and, there is no basis for assuming that if it had considered the issue, Congress would have intended to preempt state law traditionally governing such matters. Accordingly, the general language of § 15(a)(1), should not be construed to have effected such a result—nearly 50 years after the enactment of the FLSA. The provisions of state and federal law that deal directly and explicitly with the

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[11] Cases such as *Southern Advance Bay & Paper Co.* v. *United States*, 133 F.2d 449 (5th Cir. 1943); *Wirtz* v. *Lone Star Steel Co.*, 405 F.2d 668, 670 (5th Cir. 1968); and *Walling* v. *Acosta*, 140 F.2d 892, 894 (1st Cir. 1944), on which the Secretary relies (Resp. Br. 9-10), therefore, provide no support for the contention that § 15(a)(1) should be extended to an innocent secured creditor.

relative priorities of creditors' claims deserve far more careful consideration than the Sixth Circuit's implicit repeal. Unlike the government, the Sixth Circuit clearly acknowledged the conflict. For the reasons stated in the petition and by the NCFA as *amicus curiae*, it is a conflict that will have significant consequences for the nation's commercial lending industry unless promptly resolved.

CONCLUSION

The petition for a writ of certiorari to the Sixth Circuit should be granted.

Respectfully submitted,

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No. 86-88

In The
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CITICORP INDUSTRIAL CREDIT, INC.,
Petitioner,

v.

WILLIAM E. BROCK, SECRETARY OF LABOR, UNITED STATES DEPARTMENT OF LABOR,
Respondent.

BRIEF OF NATIONAL COMMERCIAL FINANCE ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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INTEREST OF AMICUS

The National Commercial Finance Association ("NCFA") is a non-profit membership corporation organized under the laws of Delaware, with its principal office in New York.[1] NCFA is the national trade association for financial institutions that provide asset-based commercial financing and factoring. It has more than 230 members, including Petitioner Citicorp and substantially all of the major "money center" and regional banks, small commercial lenders, and large publicly-held commercial lenders.

Members of the NCFA operate on a national, regional and local scale, providing both operating funds and acquisition financing to businesses, often through the financing of accounts receivable and inventory on a revolving basis. Many of these businesses are small and medium-sized enterprises which depend upon the availability of secured financing for their existence and growth. For example, inventory financing may allow a borrower to purchase inventory needed for cyclical or seasonal build-ups or to supplement cash needs during periods of low volume. Similarly, secured acquisition financing in leveraged buyouts has played a major role in the decentralization and revitalization of many enterprises in relatively mature manufacturing industries, and the growth of new technology in modest-sized companies.[2]

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1 This Brief is filed with the consent of the parties; letters reflecting consent are on file with the Clerk.

2 *See generally* Dodsworth, *How Mr. Simon Opened The Floodgates; U.S. Leveraged Buyouts,* Financial Times, Dec.

(Continued on following page)

Secured financing has grown dramatically and has become a significant part of the national credit market. Total outstanding financing by the commercial finance and factoring industry has increased substantially in recent decades to more than $55 Billion in 1985.

As business people, the members of the NCFA expect to take risks on secured loans. They know that there is a danger of insolvency and sometimes fraud. They also know that their security interests will be inferior to earlier perfected liens and security interests. Before making their loans, therefore, secured lenders review the appropriate public records to determine the relative priority of their security interests in the collateral. This review permits them to consider the highly competitive market price for their loans and services in light of the risks of asset-based financing. The borrowers with whom they will do business and the structure and amount of the secured transaction turn, in large measure, on the established expectations resulting from notoriety of liens and security interests in the public record.

The Uniform Commercial Code provides the uniformity and certainty that are essential to the availability of modern secured lending, particularly to small businesses for which credit otherwise might be unavailable. More

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(Continued from previous page)

5, 1985 at 14 ("leveraged buyouts . . . have taken Wall Street by storm"); Williams, *Leveraged Buyouts Outpace Purchases By Private Concerns,* Wall St. J., Aug. 12, 1985 at 13, Col. 2; DeAngelo & DeAngelo, *The Numbers Show Everyone Profits,* N.Y. Times, Jan. 22, 1984 Section 3 at 2, Col. 2; Brown, *Leveraged Buyouts 1983's Rage,* Wash. Post, Dec. 7, 1983 at D8, Col. 3; Waters, *The Leveraged Buyout Boom,* Inc. Sept. 1983 at 46; *Why Leveraged Buyouts Are Getting So Hot,* Bus. Wk., June 27, 1983 at 86.

specifically, the Code permits commercial lenders to determine the risks associated with proposed loans from superior liens quickly and efficiently by checking public filings. In addition, the Code discourages secret encumbrances, while permitting flexible security devices designed to satisfy modern commercial needs. At least in part for these reasons, the Code has become a truly national law of commerce, adopted in 49 states, Puerto Rico, and the District of Columbia.

The Secretary's position, which has been adopted by the Sixth Circuit in direct and acknowledged conflict with settled precedent in the Second and Fourth Circuits, is that lenders with a security interest in inventory may be enjoined from foreclosing on their collateral under the "hot goods" provision of the Fair Labor Standards Act ("FLSA"), 15 U.S.C. § 215(a)(1), for violations of that Act by their borrowers. The Sixth Circuit's holding in this case will generate confusion and uncertainty in the secured lending industry and disrupt long-established commercial practice based on the Uniform Commercial Code. Furthermore, secured lenders who lend to borrowers with at least one facility in the Sixth Circuit (or any other jurisdiction except the Second or Fourth) will be forced to modify their advance ratios, interest rates or other loan terms to reflect the added risk to repayment of their loans introduced by the Sixth Circuit's decision. The result will be to tighten credit for borrowers or, in some cases, to make credit unavailable to enterprises that may be unable to obtain credit from any other source. Members of NCFA therefore will be directly and adversely affected by the Sixth Circuit's decision, and by the uncertainty that decision has created.

REASONS FOR GRANTING THE PETITION

I. THE CONFLICTING HOLDINGS OF THE COURTS OF APPEALS CREATE SUBSTANTIAL PRACTICAL PROBLEMS FOR THE COMMERCIAL LENDING INDUSTRY.

The Sixth Circuit acknowledged that its holding in this case conflicts with the holdings of both the Second Circuit in *Wirtz v. Powell Knitting Mills,* 360 F.2d 730 (2d Cir. 1966), and the Fourth Circuit in *Schultz v. Factors, Inc.,* 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971).[3] As the Second Circuit Court of Appeals pointed out in *Powell Knitting Mills, supra,* the position advanced by the Secretary of Labor in that action (as in this one), apparently was first conceived by the Secretary in the mid-1960's, "in spite of the myriad of instances in which similar security titles must have been enforced." 360 F.2d at 733. In the next reported decision, the Fourth Circuit was convinced by the "admirable clarity" of the *Powell Knitting Mills* decision, and rejected the Secretary's position. *Factors, supra,* at 44,732. The Secretary's first reported foray into the Sixth Circuit on this theory occurred in 1975. *Dunlop v. Sportsmaster, Inc.,* 77 Lab. Cas. ¶ 33,293 (E.D. Tenn. 1975). Once again, the court rejected the Secretary's theory.

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[3] In *Powell Knitting Mills,* the Second Circuit adopted "a rule that frees from Section 15 only a creditor foreclosing like Meinhard, for nonpayment of funds previously advanced." 360 F.2d at 732. The Sixth Circuit majority states that "Although we are reluctant to create an inter-circuit conflict, we cannot agree with the Second Circuit's judicially created exception." Pet. App. 9a. The Sixth Circuit majority concludes as follows: "We therefore, reject the reasoning in *Powell Knitting Mills* and hold that 29 U.S.C. Section 215(a)(1) applies to secured creditors." Pet. App. 12a.

In the decades during which the Secretary unsuccessfully sought judicial approval of his interpretation of § 15(a)(1), commercial lenders reasonably relied on settled law in structuring their transactions. Now that the Secretary has received judicial support for his position, however, there is every reason to assume that the Secretary will seek to implement and extend this ruling in other circuits. *See, e.g.,* Pet. App. 9a n.8. Many opportunities for the Secretary to test his theory in other circuits necessarily will arise, since virtually every failed business that has relied on secured credit will leave some employees who have not been paid all of their final wages.

As Judge Engel's dissent points out, *see* Pet. App. 15a, the "uniform national construction of the Act," which has been in effect for nearly 20 years, has been destroyed. This is not a case involving a newly adopted law, where the reliance interests are minimal and judicial consideration has been limited. The Sixth Circuit's decision destroys the highly desirable national uniformity regarding § 15(a)(1), and introduces an entirely new, revolutionary reading of the provision. The impact of overturning a rule of law that has been "uniformly held . . . over a long period of time," *id.* at 16a, is far more significant than the impact of rejecting the first tentative constructions of a new statute. These circumstances weigh heavily in favor of immediate consideration by this Court.

Furthermore, there is a very real threat of unfair forum shopping by the Department of Labor. Many borrowers conduct operations and maintain inventory in multiple states. To the extent any of the borrowers' operations are located in the Sixth Circuit, the Secretary is likely to bring an enforcement action in the Sixth Circuit, seeking, how-

ever, to restrain the sale or movement of *all* of the inventory, wherever located.

In addition, the risks to secured lenders inherent in litigation delay are significant, even if all of the courts outside the Sixth Circuit eventually reject the Secretary's novel theory. A secured lender has a strong interest in liquidating his collateral promptly, particularly if the collateral may be insufficient to permit recovery of both principal and interest on the outstanding debt, or if the collateral is either perishable or seasonal in nature. If the collateral is insufficient, the lender will be denied the use of his funds and the interest that could be earned on those funds while litigation is pending. If the collateral is perishable or seasonal, there is a risk that it will become worthless before formal proceedings can be concluded. Thus, frequently the threat of litigation and the possibility that the Sixth Circuit's interpretation of Section 15(a)(1) may be adopted will be sufficient to force capitulation by the creditor without litigation. However frequently the issue arises, therefore, the Secretary's distortion of the "hot goods" provision may receive only random and intermittent judicial scrutiny, even at the district court level; litigation that does arise may seldom reach an appellate court.[4]

Accordingly, the conflict is one whose continued existence can no longer be tolerated. It must be resolved now, before it causes further mischief.

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[4] *See* C.A. App. 66 (counsel for the Secretary explained: "Your Honor, there's not much case law, as TROs have been issued, usually, and after they are issued parties get together, pay everybody, and [the case] never goes any farther than that.")

II. THE RULE ADOPTED BY THE SIXTH CIRCUIT WILL DISCOURAGE SECURED LENDING.

In his dissent below Judge Engel stated that, "The need for a uniform national construction of the Act is obvious." 788 F.2d at 1207. Because of the Sixth Circuit's decision, the many NCFA members who do business on a national or regional scale must consider reducing loan availability or increasing interest rates, even on loans secured in large part by inventory outside the Sixth Circuit. A lender making loans to a debtor with a manufacturing plant in New York (Second Circuit) and a warehouse in Ohio (Sixth Circuit) must assume for purposes of credit risk analysis that the Secretary would bring any action under § 15(a)(1) of the FLSA in the Sixth Circuit, and must therefore reduce its lending availability formula on *all* of the inventory collateral, wherever located. When lenders can predict that this new "secret lien" may be invoked, the availability of credit will be lessened as the advance rate against inventory is reduced or, in some cases, no inventory loans will be made.

In circuits other than the Second, Fourth or Sixth Circuits there is a new and meaningful uncertainty as to the value of inventory as collateral. Prior to this ruling, most secured lenders justifiably assumed that sales of their inventory collateral were not subject to injunction under the FLSA. This assumption is no longer reliable outside of the Sixth Circuit. Such uncertainty for those engaged in national financial transactions is directly contrary to the important policies recognized by this Court

in *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 739-740 (1979).[5]

There can be no doubt about how often this new federal "lien" could be invoked. In an era where failed ventures are common, it is equally common to find unpaid employees at the time a business terminates due to insolvency. The Secretary's new weapon, if allowed to persist, will be a serious disruptive element in the commercial lending industry, which now in the Sixth Circuit is apparently required to assist the Secretary in enforcing compliance with the FLSA.

Commercial lenders place a high priority upon predictability and uniformity of legal consequences in determining how much credit to extend, and what advance rates to employ in managing that credit, particularly in transactions with a borrower having multi-state or national operations. For borrowers without easy access to the credit markets, such as most small or medium-sized companies, the uncertainty brought about by the conflict between the circuits may discourage a secured lender from extending credit. This uncertainty and unpredictability normally will require larger loan reserves, reducing the amount of credit available to the borrower.

Another consequence of the Sixth Circuit's ruling is to cause a secured lender with inventory collateral to protect itself against possible loss of collateral at least equal to wages for several pay periods of its borrowers. Borrowers in poor financial condition probably will not find credit available to continue operations. This will precipitate, in some cases, repayment demands for loans, earlier closing of businesses and earlier termination of employment in businesses that might otherwise have survived.

The Sixth Circuit assumed that its decision would require secured lenders to exercise a greater amount of supervision over the operations of their borrowers to assure that wage payments are made. *See, e.g.*, Pet. App. 24a. This proposed role for secured creditors is not feasible or prudent, and presents a variety of serious business and legal problems. In an ordinary case of an insolvent borrower, a secured creditor has no knowledge whether workers are, or are not, being paid on a current basis, and could not assure such payments except by making loans in excess of normal availability, and by keeping its own auditors on the borrower's premises. Prospective borrowers would not be interested in arrangements with a lender that proposes to monitor and interfere with the operation of their businesses; secured lenders would not be interested in risking claims that they had thereby exercised dominion and control over their borrowers that could result in a loss of their security interests or a finding that they should be equitably subordinated to the rights of other creditors.[6]

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5 "In structuring financial transactions, businessmen depend on state commercial law to provide the stability essential for reliable evaluation of the risks involved. . . .

"Because the ultimate consequences of altering settled commercial practices are so difficult to foresee, we hesitate to create new uncertainties, in the absence of careful legislative deliberations."

6 *See Taylor v. Standard Gas & Electric Company*, 306 U.S. 307 (1939); *In re Process-Manz Press*, 236 F. Supp. 333 (N.D. Ill. 1964), *rev'd on jurisdictional grounds*, 369 F.2d 513 (7th Cir. 1966), *cert. denied sub nom Limperis v. A.J. Armstrong* Co., 386 U.S. 957 (1967); A. DeNatale and P. Abram, *The Doctrine of Equitable Subordination as Applied to Non-Managerment Creditors*, 40 Business Lawyer 417, 432-445 (1985).

III. ENFORCING SECTION 15(a)(1) AGAINST THE INTERESTS OF SECURED LENDERS DOES NOT FURTHER THE PURPOSE OR POLICY OF THE FLSA.

In *Powell Knitting Mills,* the Second Circuit recognized that, in making unlawful the sale of goods produced in violation of the FLSA, Congress provided some protection from unfair competition to businesses that "complied with the Act." 360 F.2d at 732. Because the debtor in *Powell Knitting* was insolvent, the Court correctly noted that there could be no adverse competitive effects when sale of the goods is accomplished by a foreclosing secured creditor, who sells the goods at a price determined without consideration of their cost of production.[7] In this function, the secured lender's role is similar to that of a trustee liquidating a bankrupt estate, often at prices below cost.

The Second Circuit also recognized that Section 15(a)(1) operated to provide some assurance that wage earners would get paid. 360 F.2d at 733. With an insolvent debtor, however, the only way unpaid employees can be paid is by taking money away from other creditors, including secured creditors. As the Second Circuit noted, "without some reasonably clear reference to the problem in the Act or in its history we find it hard to believe that Congress contemplated that the foreclosing creditor would have to pay the wage earners to avoid § 15." *Id.*

The Sixth Circuit states incorrectly and simplistically that one purpose of the FLSA "is to keep goods that were

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[7] *See* Samuelson, *Economics* at 380 (8th ed. 1970) ("Once a bridge is built it must earn what the traffic will bear regardless of past sunk costs."); McConnell, *Economics* at 472-73 (9th ed. 1984).

produced in violation of the FLSA out of interstate commerce." 788 F.2d at 1203. Rather, Section 15(a)(1) is one of several means to accomplish the purposes of the Act; keeping goods produced in violation of the Act out of interstate commerce is not an independent purpose of the FLSA. In any event, as noted by Judge Engel in his dissent, the goods will usually enter interstate commerce even if, as here, the Secretary obtains an injunction. "[A]lmost always the result will be that the goods are sold, if not in foreclosure, then in bankruptcy, or by other attaching creditors." 788 F.2d at 1207. If the goods do not enter commerce, it likely will be because the amount of unpaid wages exceeds the value of the goods, in which event the goods will be abandoned or destroyed, and the employees will not be paid. The Secretary can hardly contend that that result would fulfill any purpose of the FLSA.

Further, the Secretary's interpretation of Section 15(a)(1) ignores several fundamental precepts of statutory construction. In the oft-cited case of *Church of the Holy Trinity v. United States,* 143 U.S. 457 (1892), this Court stated:

> It is a familiar rule that a thing may be within the letter of the statute and yet not within the statute because not within its spirit, nor within the intention of its makers.

143 U.S. at 459, *quoted in United Steelworkers of America v. Weber,* 443 U.S. 193, 201 (1979).[8] Absent compelling

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[8] *See Lynch v. Overholser,* 369 U.S. 705, 710 (1962) (The Court has "repeatedly warned against the dangers of an approach to statutory construction which confines itself to

(Continued on following page)

evidence that Congress intended to require secured creditors to pay the wages of the employees of their borrowers, or at least that Congress's purpose would be served by such a dramatic change in the law, the Secretary's theory should be rejected. To apply § 15(a)(1) to impair valid perfected security interests in inventory with no evidence of lender wrongdoing would not serve the purpose of the FLSA. This Court should grant the petition, endorse the reasoning of the Second and Fourth Circuits, and reverse the Sixth Circuit's decision.

(Continued from previous page)

the bare words of a statute . . . for 'literalness may strangle meaning.' ") (quoting *Utah Junk Co. v. Porter*, 328 U.S. 39, 44 (1946)); *United States v. American Trucking Associations*, 310 U.S. 534, 543-44 (1940) ("When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination.' "); *Ozawa v. United States*, 260 U.S. 178, 194 (1922) (Court should give effect to statute "in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail."); *American Tobacco Co. v. Werckmeister*, 207 U.S. 284, 293 (1907) ("But in construing a statute, we are not always confined to a literal reading . . ."); C. Sands, 2A *Sutherland Statutory Construction*, §§ 45.09, 46.01 at 40, 73 (5th Ed. 1984); R. Posner, *Statutory Intepretation—In the Classroom And In the Courtroom*, 50 U. Chi. L. Rev. 800 (1983); A. Murphy, *Old Maxims Never Die: The "Plain Meaning Rule" And Statutory Interpretation In The "Modern" Federal Courts*, 75 Colum. L. Rev. 1299 (1975).

CONCLUSION

For the foregoing reasons, Citicorp's petition for a writ of certiorari to the Sixth Circuit should be granted.

Respectfully submitted,

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No. 86-88

IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

CITICORP INDUSTRIAL CREDIT, INC.,
Petitioner,

v.

WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

Whether, in enacting the Fair Labor Standards Act, Congress intended not only to establish minimum wage rates, but also to displace the rights of bona fide purchasers and lienholders established by state and other federal law.

LIST OF PARTIES

In addition to the parties identified in the caption of the case, Ely Group, Inc. and two entities identified as Ely Group subsidiaries, Rockford Textile Mills, Inc. and Ely & Walker, Inc., were named defendants in the Secretary's complaints. Neither Ely Group nor any Ely Group subsidiary participated in the proceedings in the court of appeals.*

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* The petition for a writ of certiorari contains the disclosures required under Rule 28.1 of the Rules of this Court.

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 788 F.2d 1200. The opinions of the district courts (Pet. App. 18a-33a) are reported at 608 F. Supp. 215 (E.D. Tenn.), and 621 F. Supp. 22 (W.D. Tenn.).

JURISDICTION

The judgment of the court of appeals (Pet. App. 17a) was entered on April 23, 1986. The petition for a writ of certiorari was filed on July 22, 1986, and granted on November 3, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 15(a)(1) of the Fair Labor Standards Act of 1938 (29 U.S.C. § 215(a)(1)) provides:

> (a) After the expiration of one hundred and twenty days from June 25, 1938, it shall be unlawful for any person—
>
> (1) to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 206 or section 207 of this title, or in violation of any regulation or order of the Administrator issued under section 214 of this title; except that no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful;

Sections 6 and 7 of the Fair Labor Standards Act of 1938 (29 U.S.C. §§ 206, 207), which prescribe minimum regular wage rates and overtime wage rates for covered employees, are reproduced in the appendix to the petition for a writ of certiorari. Pet. App. 36a-56a.

STATEMENT OF THE CASE

The Sixth Circuit's decision in this case ignores two common sense distinctions. The first is the distinction—unquestioned for nearly 50 years—between wage and hour standards and creditors' rights. The second is between innocence and culpability. Both are fundamental, and compel reversal.

Traditionally, creditors' rights (including employee wage claims) against insolvent debtors not in bankruptcy have been governed by a well-developed set of interrelated state laws. On the few occasions when Congress has acted in this area of creditors' rights, the legislation has been drawn narrowly, leaving the area of creditors' rights outside bankruptcy governed almost exclusively by state law. In bankruptcy, of course, the federal Bankruptcy Code governs. By contrast, the relationships between employees of ongoing businesses and their employers have been governed by an entirely separate and distinct body of law.

The Fair Labor Standards Act of 1938 ("FLSA") is one of several general federal statutes addressing employer-employee relations. The focus of the FLSA is the wage rates and hours of employees of ongoing businesses. The Act does not purport to govern in any way the consequences of an employer's insolvency or to modify the priority of creditors' claims against an insolvent debtor's assets. In addition, there is no evidence that the FLSA was intended to make innocent persons responsible for any employer's payroll obligations.

The Sixth Circuit held that in enacting the FLSA Congress intended not only to establish decent wage rates and hours for American workers, but also to preempt the substantial body of state law governing creditors' rights against insolvent debtors, and to repeal provisions of the bankruptcy law by implication. In the nearly 50 years since the FLSA was enacted, no other court of appeals has interpreted the statute to require such an extraordinary conclusion.

1. *Factual context.* This case arises out of a typical commercial secured lending transaction. Ely Group, Inc. ("Ely") is a defunct manufacturer of hosiery and shirts.

In December, 1983, petitioner Citicorp Industrial Credit, Inc. ("Citicorp") and Ely executed a standard financing agreement. C.A. App. 343-411; see *id.* 340-342.[1] Ely granted Citicorp a security interest in its accounts receivable and inventory as collateral to secure repayment of loans to be made by Citicorp under the agreement. C.A. App. 356-357.[2] Citicorp "perfected" its security interests under applicable state law (Article 9 of the Uniform Commercial Code) by filing financing statements with appropriate state officials. Pet. App. 2a, 19a-20a; C.A. App. 33, 44, 75, 288, 418.[3]

Approximately one year later, Ely defaulted on its obligations under the financing agreement, and on February 11, 1985, Citicorp notified Ely that no additional funds would be advanced. C.A. App. 412-413. The financing agreement provides that the law of Georgia governs the rights and obligations of the parties. C.A. App. 383. Under Georgia law, Citicorp's perfected security interest in the Ely inventory is senior to all secured and unsecured claims to that inventory, including employee wage liens created by state statute. See Ga. Code Ann. §§ 11-9-310, 44-14-320 (1982).[4] Accordingly, under Georgia law

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[1] "C.A. App." refers to the joint appendix filed in the court of appeals. When the financing agreement was executed, Ely Group was known as Qualitex Corporation. Pet. App. 2a.

[2] Under the agreement, payments from Ely's customers were deposited in a Citicorp account, and applied against the advances made by Citicorp. C.A. App. 189-190, 208-209, 321-322.

[3] "Perfection" by filing with designated state officials is the procedure established under Article 9 of the Uniform Commercial Code for recording security interests, and thereby putting prospective creditors on notice of prior claims against almost every type of property of a debtor. *See generally* 1 G. Gilmore, *Security Interests in Personal Property* 435-437, 462-480 (1965).

[4] A "lien" is a charge against property for the payment of a debt and gives the creditor lienholder the right to have the debt satisfied out of the proceeds of sale of the particular property to which the lien attaches. *See Ballentine's Law Dictionary* 737 (3d ed. 1969).

Citicorp would have been entitled to take possession of and sell the Ely inventory in satisfaction of its claims, without regard to the claims of Ely's employees for unpaid wages.[5]

At the request of Ely's management, Citicorp delayed exercising its right to take possession of the inventory to give Ely an opportunity to devise a plan to continue operations and to pursue alternative sources of financing. C.A. App. 301-302. Approximately one week later, on February 19, 1985, Ely ceased operations, and turned over the inventory collateral to Citicorp. Pet. App. 3a. Citicorp then planned to collect Ely's receivables, and to liquidate the inventory collateral and apply the proceeds against the outstanding Ely loan balance of approximately $9.5 million. See Pet. App. 3a.

When Ely ceased operations, it owed its employees wages for work performed during the immediately preceding weeks. Pet. App. 27a, 29a-30a. Some payroll checks issued on February 8 had been dishonored for insufficient funds; no payroll checks were issued after that date. C.A. App. 120, 281. Ely is therefore liable under state law for the wages due its employees. The precise amount of unpaid wages has not been determined.

2. *District court proceedings.* In March, 1985 respondent Secretary of Labor filed two suits under Sections 15, 16, and 17 of the Fair Labor Standards Act (29 U.S.C. §§ 215, 216, 217) against Ely and Citicorp in the United States District Courts for the Eastern District of Ten-

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[5] Statutory liens for employee wages also are provided for by statute in Arkansas and Tennessee, where Ely's facilities were located. *See* Ark. Stat. Ann. §§ 51-505, 51-301 (1971); Tenn. Code Ann. § 66-13-101 (1982). The priority of Citicorp's security interest over employee wage liens under Tennessee law, if applicable, is the subject of pending state court litigation. *Bobbie Atnip* v. *Ely Group, Inc., et al.*, No. 3724 (Chancery Court, Warren Cty., Tenn.) (filed Feb. 25, 1985).

nessee and the Western District of Tennessee.[6] In both actions, the Secretary sought to enjoin the sale or shipment of all Ely inventory; the Secretary also sought a judgment against Ely for unpaid wages and liquidated damages on behalf of Ely employees. C.A. App. 4-7 (E.D. Tenn.), 110-114 (W.D. Tenn.).

Sections 6 and 7 of the FLSA prescribe minimum regular wage rates and overtime wage rates for covered employees. 29 U.S.C. §§ 206, 207 (Pet. App. 36a-56a). Section 15(a)(1), one of several mechanisms Congress adopted to induce employers to comply with the substantive provisions of the Act, makes it unlawful for "any person" to transport, sell, or ship in commerce goods produced by employees not paid the prescribed minimum wages. Section 16 authorizes the Secretary to seek unpaid minimum wages and liquidated damages on behalf of employees. Under Section 17 of the Act, federal district courts have jurisdiction to enjoin violations of Section 15.

The Secretary maintains that an insolvent employer's financial inability to pay employees in accordance with their respective employment contracts violates the minimum wage and overtime provisions of the FLSA. It is undisputed that Ely's wage rates exceeded the minimum requirements of Sections 6 and 7 of the FLSA. C.A. App. 34; see Pet. App. 13a.

There is no evidence of wrongdoing by Citicorp, or of any participation by Citicorp in Ely management's decisions concerning the use of funds to pay employees or other creditors. Pet. App. 25a-26a, 32a; see Pet. App. 10a. On the basis of the asserted violation of Sections 6

[6] *Donovan* v. *Rockford Textile Mills, Inc., Ely Group, Inc., and Citicorp Industrial Credit, Inc.*, Civ. Action No. 4-85-26 (E.D. Tenn.) (complaint filed March 15, 1985); *Ford* v. *Ely Group, Inc., Rockford Textile Mills, Inc., Ely & Walker, Inc., and Citicorp Industrial Credit, Inc.*, Civ. Action No. 85-2276H (W.D. Tenn.) (complaint filed March 21, 1985).

and 7 by Ely, however, the Secretary invoked Section 15(a)(1) against Citicorp, arguing that because Section 15(a)(1) makes it unlawful for "any person" to sell goods produced in violation of the Act, Congress intended it to apply to secured creditors who had nothing to do with either the establishment of employee wage rates or the payment of employee wages. Under the Secretary's theory, when a secured creditor takes possession of "tainted" goods pursuant to a valid security agreement and in accordance with applicable state law, the creditor may not sell the collateral, unless the debtor's employees are paid first, without regard to state law governing the relative priority of creditors' claims.

In the district court, counsel for the Secretary candidly admitted both the motivation for, and the practical effect of, invoking Section 15(a)(1) against a secured creditor. Responding to questions from the district court, counsel agreed that the injunction sought against Citicorp was "judicial extortion." C.A. App. 66-67. Counsel for the Secretary explained that although an injunction entered under Section 15(a)(1) would not "order any payment by anyone," it "puts pressure on either party [*i.e.*, the insolvent employer and the secured creditor] to arrange for payment [of employee wages]." C.A. App. 42-43. See also C.A. App. 57, 58. Similarly, counsel for the Secretary acknowledged that invoking Section 15(a)(1) against a secured creditor effectively gave the employees priority, notwithstanding any contrary state law. See C.A. App. 57 (counsel for the Secretary noted "[w]e're saying employees have priority").[7]

[7] *See also* C.A. App. 67 (emphasis added):

"The Court: So you are just simply saying any time . . . that any kind of goods are moved in the United States, and the minimum wage is not paid, that all those goods have to sit where they are, *and a creditor has no lien ahead of the payroll*, is that right?

"[Counsel for the Secretary]: Yes, sir."

Both district courts accepted the Secretary's theory, and enjoined Citicorp from selling any Ely inventory produced during the period for which Ely employees had not been fully paid.[8] Over the opposition of the Secretary, the district court judgments were stayed pending appeal. Citicorp was permitted to sell the inventory collateral on condition that it hold the proceeds of sales in a separate account and agree to pay the statutorily required wages due Ely employees, if Section 15(a)(1) were held applicable.[9]

3. *Court of appeals proceedings.* The cases were consolidated in the United States Court of Appeals for the Sixth Circuit. In affirming the district court judgments, the court of appeals explicitly declined to follow the contrary holdings in *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971), and *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730 (2d Cir. 1966). Pet. App. 7a-8a.[10] In *Powell Knitting*, the Second Circuit rejected the Secretary's assertion that Congress intended Section 15(a)(1) to be used to modify state priority rules or as a means to force an innocent secured creditor to pay the wages of the employees of an insolvent: "[W]ithout some reasonably clear reference to the problem in the Act or in its history we find it hard to believe that Congress contemplated that the foreclosing creditor would have to pay the wage earners to avoid § 15." 360 F.2d 733.

[8] C.A. App. 79-80, 427.

[9] Pet. App. 4a; C.A. App. 104-105, 432-433; *see* Pet. App. 10a n.9 ("Citicorp . . . removed the 'taint' from the goods by agreeing to pay the statutorily required wages if . . . 29 U.S.C. § 215(a)(1) applies to secured creditors"). Subsequently, the conditions of the stay were modified to allow Citicorp to reduce the amount of money held separate for payment of Ely employee wage claims to $1.5 million. Pet. App. 34a-35a.

[10] In *Shultz* v. *Factors, Inc.*, the Fourth Circuit adopted the reasoning in *Powell Knitting*, adding the explicit caveat that a different result might be appropriate if there were evidence of a secured creditor's "complicity" in any attempt to circumvent the substantive requirements of the FLSA. 65 Lab. Cas. 44,732.

The Sixth Circuit acknowledged that "Congress never directly considered the question whether the 'hot goods' provision [29 U.S.C. § 215(a)(1)] applies to secured creditors." Pet. App. 12a. Nonetheless, relying on the phrase "any person" in Section 15 and its view that enforcing Section 15(a)(1) against a secured creditor would further Congress' purpose to protect business against competition from goods produced under substandard labor conditions, the majority held that an innocent secured creditor foreclosing on inventory collateral was subject to injunction under Section 15. Pet. App. 4a-7a.[11]

Judge Engel dissented, stating that, after decades of settled law in this area, the court should follow the construction of the FLSA adopted by the other courts of appeals, absent compelling reason for rejecting that view. Moreover, Judge Engel argued that the minimum wage provisions of the Fair Labor Standards Act were never intended to apply to an insolvent employer, unable to pay any wages at all. Pet. App. 13a. Judge Engel recognized that the Secretary's only "motivation" for invoking Section 15 against a secured creditor of a financially distressed employer was to pressure the creditor to pay the wages of its debtor's employees. Pet. App. 15a. Judge Engel explained that, in holding Section 15(a)(1) applicable to a secured creditor, the majority effectively "create[d] a judicial lien superior to the otherwise lawful lien which Citicorp possessed in the goods." Pet.

[11] As noted above (page 8 & note 9, *supra*), the court of appeals permitted Citicorp to sell the inventory on condition that it agree to pay the Ely employees' unpaid, statutorily required wages if Section 15(a)(1) were held applicable under the circumstances of this case. The court thus implicitly rejected any suggestion that the inventory was either inherently or permanently "tainted" contraband.

App. 15a. Since there was no evidence Congress intended Section 15 to apply to a secured creditor, Judge Engel concluded that Congress intended to permit the claims of employees of insolvent corporations to be governed by "traditional sources of law," namely, "[s]tate laws governing creditors' rights, state laws protecting employees from non-payment of wages and bankruptcy laws generally." Pet. App. 15a.

SUMMARY OF ARGUMENT

The Secretary of Labor maintains that an insolvent employer's failure to meet the last payroll before shutting down operations violates the minimum wage and hour standards of the Fair Labor Standards Act, and therefore that the "hot goods" provision of the Act (29 U.S.C. § 215(a)(1)) is properly invoked against wholly innocent persons who acquire goods produced by the insolvent's employees. Both propositions defy common sense; the latter is demonstrably incorrect.

For 150 years prior to the enactment of the Fair Labor Standards Act of 1938 ("FLSA"), the priority of creditors' claims against the assets of insolvent debtors not in bankruptcy was governed by state law. For nearly 50 years after the Fair Labor Standards Act was adopted, the bright line between creditors' rights on one side and wage and hour standards on the other remained clear. The Sixth Circuit's construction of Section 15(a)(1) in this case is the only departure from that clear line. In holding that Section 15(a)(1) of the FLSA may be invoked to freeze goods in the possession of an innocent secured creditor attempting to foreclose a prior perfected security interest in inventory collateral, the Sixth Circuit effectively created a federal wage lien. Unless the creditor pays (or in this case agrees to pay) the wages due the employees of its insolvent debtor, the inventory collateral cannot be sold. The lien created by the Sixth Circuit preempts contrary state law throughout

the nation and repeals by implication other federal law explicitly addressing creditors' rights.

The plain language of the Fair Labor Standards Act provides no basis for the court of appeals' conclusion that Congress intended to preempt the substantial body of state law governing the priority of creditors' claims against the assets of insolvent debtors. On the contrary, the language and structure of the FLSA reflect Congress' limited purpose and intention to improve the wages and hours of the employees of ongoing businesses by establishing minimum labor standards. Section 15(a)(1) of the FLSA was intended as a mechanism to induce employers to comply with the substantive wage and hour standards prescribed in the Act. Section 15(a)(1), like the substantive provisions of the Act, deals with the limited problem of "chiseling" employers who refused to pay decent wages, not the very different problem of collecting wages from insolvent employers. Nothing in the language of the FLSA purports to address the consequences of an insolvent employer's inability to pay agreed wages in excess of the minimum rates prescribed in the substantive provisions of the Act, or to preempt the state law of creditors' rights.

The legislative history of the FLSA confirms that Section 15(a)(1) was aimed at chiseling employers and those who aided them in attempting to circumvent the substantive wage and hour provisions. The provision was never intended to be invoked against any person who innocently acquired hot goods in good faith, without complicity in any scheme to circumvent the substantive wage and hour standards prescribed in the Act. Congress amended Section 15(a)(1) in 1949 to confirm the originally intended scope of Section 15(a)(1). Contrary to the Secretary's current interpretation, in 1949 Congress made it clear that Section 15(a)(1) was never intended to make innocent purchasers of hot goods responsible for the failure of their sellers to abide the substantive requirements of the FLSA.

Given the limited purpose of the FLSA, it is inconceivable that Congress actually considered and intended to establish a federal wage lien with priority over a perfected secured creditor. The 1938 amendments to the Bankruptcy Act of 1898 (amendments commonly referred to as the Chandler Act) eliminate all doubt. Just three days before the Fair Labor Standards Act became law, Congress amended the bankruptcy laws, but continued to recognize the validity of prior perfected liens as against the claims of unsecured creditors, including employee wage claims. Thus, employee wage claims remained junior to prior perfected security interests. Unlike the FLSA, the Bankruptcy Act addresses the priority of creditors' claims against the assets of an insolvent debtor. The Sixth Circuit's interpretation of the FLSA requires the erroneous conclusion that three days after amending the Bankruptcy Act, Congress silently repealed it in part in legislation addressing an entirely different subject. The same conflict exists under the Bankruptcy Code today; in addition to the Bankruptcy Code, the holding of the Sixth Circuit improperly repeals by implication several other federal statutes that specifically address the priority of creditors' claims to the assets of an insolvent debtor.

Whether the product of a decision of this Court or a well-reasoned decision of a lower federal court, a settled construction of a national statute should not be revisited without good reason. In this case, there is none. The decision of the Second Circuit in *Powell Knitting* was correct in 1966, and in 1971 when the Fourth Circuit adopted its reasoning in *Shultz* v. *Factors, Inc.* The common sense distinction between wage and hour legislation and creditors' rights legislation recognized in *Powell Knitting*, is no less valid today; in the intervening decades commercial finance industry practices and loan agreements have been developed in reliance on that distinction. The laws governing creditors' rights and the laws governing wage and hour legislation have stood

side-by-side for at least 50 years, each operating independent of the other, with no ill effects. There is no reason to stretch the Fair Labor Standards Act to reach an area it was never intended to govern.

ARGUMENT

THE FAIR LABOR STANDARDS ACT SHOULD NOT BE CONSTRUED TO PREEMPT OR REPEAL STATE AND FEDERAL LAW GOVERNING THE RELATIVE PRIORITY OF CREDITORS' CLAIMS AGAINST INSOLVENT DEBTORS

Resolution of the question presented depends on congressional intent. In holding that Section 15(a)(1) of the FLSA may be used to compel a secured creditor to pay the wages of its debtor's employees, the Sixth Circuit effectively established an unfiled (see note 3, page 4, *supra*) and, therefore, undiscoverable "secret" lien for wages with super-priority over prior perfected security interests in inventory collateral, contrary to the order of priority generally prescribed under state law as well as under the Bankruptcy Code.[12] As construed by the Sixth Circuit, therefore, the Fair Labor Standards Act preempts state law governing the priority of creditors' claims against the assets of insolvent debtors and repeals by implication other federal law specifically addressing creditors' rights.

"The critical question in any pre-emption analysis is always whether Congress intended that federal regulation supersede state law." *Louisiana Public Service Commission* v. *Federal Communications Commission*, 106 S. Ct. 1890, 1899 (1986).[13] Similarly, "absent a clearly

[12] Under both Article 9 of the Uniform Commercial Code and the Bankruptcy Code, a prior perfected security interest generally is senior to employee wages claims and liens. *See* pages 38-40, 43, *infra*.

[13] "Preemption occurs when Congress, in enacting a federal statute, expresses a clear intent to pre-empt state law . . ., when there is outright or actual conflict between federal and state law . . ., where compliance with both federal and state law is in effect

expressed congressional intention to the contrary," a federal statute should not be construed as an implicit repeal of other federal law. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1018 (1984).

The Secretary's burden of demonstrating that Congress intended to preempt state law or repeal other federal law governing creditors' rights cannot be sustained in this case. State law and federal bankruptcy law traditionally determined whether and to what extent wage claims of employees of insolvent businesses should be afforded special protection. The focus of the FLSA was the ongoing relationship between employers and their employees. In enacting the FLSA, Congress intended only to establish minimum regular and overtime wage rates, and to prescribe rules for the employment of children. There is no evidence that in enacting the FLSA Congress intended to address the priority of creditors' claims against the assets of insolvent debtors. Neither the Secretary nor the Sixth Circuit majority has cited anything that suggests that Congress ever considered the problem of whether the wage claims of the employees of insolvent businesses should be preferred over the claims of secured creditors.

A. The Language and Structure of the FLSA Demonstrate That Section 15(a)(1) Was Not Intended to Preempt State Law Governing the Priority of Creditors' Claims Against Insolvents.

When read in the light cast by the substantive wage and hour provisions of the FLSA and the object and

physically impossible . . ., where there is implicit in federal law a barrier to state regulation . . ., where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the States to supplement federal law . . ., or where state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress." *Louisiana Public Service Commission* v. *FCC*, *supra*, 106 S. Ct. 1898 (citations omitted).

policy of the Act, it is plain that Section 15(a)(1) was never intended to prevent a secured creditor from liquidating inventory collateral in accordance with state law governing the rights of creditors.[14] Nor was it intended to be used as a club for "judicial extortion" (C.A. App. 66-67) to coerce a person who innocently acquired hot goods to pay the wages of the employees of an offending employer.

Language of § 15(a)(1). Section 15(a)(1) makes it unlawful for "any person" "to transport, offer for transportation, ship, deliver, or sell in commerce . . . any goods in the production of which any employee was employed in violation of section 6 or section 7" of the FLSA. By its terms Section 15(a)(1) does not create any rights of any kind for employees. There is no provision for recovery of unpaid wages by the government on behalf of employees under Section 15(a)(1).[15] The language of

[14] *See Kelly* v. *Robinson*, 107 S. Ct. 353, 358 (1986), quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring) ("[T]he 'starting point in every case involving construction of a statute is the language itself.' But the text is only the starting point."); *Offshore Logistics, Inc.* v. *Tallentire*, 106 S. Ct. 2485, 2494 (1986) (internal quotation marks and citations omitted) ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy").

[15] As enacted in 1938, the FLSA contained no provision at all for recovery of unpaid wages by the government on behalf of employees. Section 16 made an employer who failed to meet the minimum wage rate requirements liable to his employees for the amount of unpaid minimum wages and liquidated damages. 52 Stat. 1069. An aggrieved employee could sue his employer in any court of competent jurisdiction, but no action on his behalf by the Administrator of the Wage and Hour Division of the Department of Labor was authorized. Congress amended Section 16 of the statute in 1949 to allow the Secretary of Labor to sue an offending employer for unpaid wages on behalf of aggrieved employees. 63 Stat. 919, as amended, 29 U.S.C. § 216(c); *see generally Donovan* v. *Brown Equipment and Service Tools, Inc.*, 666 F.2d 148, 155-156 (5th Cir. 1982).

Section 15(a)(1) does not purport to create a federal wage lien on the assets of an offending employer. Nor does the provision purport to preempt state law rules governing the priority of creditors' claims against the assets of insolvent debtors. On its face, Section 15(a)(1) simply does not address the subject of creditors' rights. It is only a mechanism to encourage compliance with substantive requirements prescribed elsewhere in the Act.

Structure of the FLSA. As enacted in 1938, the FLSA accomplished three substantive objectives, two of which the Secretary relies on in this case. Section 6 prescribed minimum regular hourly wage rates.[16] Section 7 prescribed minimum overtime hourly wage rates.[17] The substantive requirements of Sections 6 and 7 govern the wages to be paid by "employers." Pet. App. 46a, 43a. Those provisions address wage rates, rather than the problem of nonpayment due to insolvency. The language of those provisions gives no hint that they were intended to govern the consequences of an employer's insolvency, or otherwise address the subject of creditors' rights against insolvents.

Moreover, as a practical matter, the substantive provisions of the Act are meaningful only in the context of an ongoing solvent business, since an employer cannot pay money it does not have.[18] If, as in this case, an employer contracts to pay wages in excess of the statutory minima, but cannot meet the payroll in the weeks before shutting down operations due to insolvency, the substantive requirements of the FLSA add nothing. The employer's obligation under state law to pay the full amount of the wages due is not in dispute. The problem is a practical one of collection. If the employer had sufficient assets, the wages would be paid, or the employee could collect on his state law contract claim. If the employer has insufficient assets, the employee is not going to collect, however many independent legal grounds he may enjoy as the basis for collecting his wages. Accordingly, the substantive provisions of the Act necessarily were aimed principally at the wage rates and hours of employees of ongoing solvent businesses.

Like the substantive provisions of the Act, Section 15(a)(1) was aimed principally at ongoing solvent businesses. The threat of an injunction against the offending employer carries little weight when, as in this case, the employer is forced to cease operations due to insolvency.[19] Further, while Section 15(a)(1) refers to "any person," that language must be interpreted in light of the substantive provisions it was intended to enforce. It is difficult to imagine circumstances in which the threat of invoking Section 15(a)(1) against a secured creditor or any other person who innocently acquires hot goods would encourage compliance by an offending employer.

[16] 52 Stat. 1062-1063, as amended, 29 U.S.C. § 206 (Pet. App. 36a-42a).

[17] 52 Stat. 1063-1064, as amended, 29 U.S.C. § 207 (Pet. App. 43a-56a). The third important substantive objective of the 1938 legislation was the establishment of child labor standards. *See* FLSA §§ 3(l) and 12, 52 Stat. 1061, 1067, as amended, 29 U.S.C. §§ 203(l), 212.

[18] In arguing that the substantive provisions of the FLSA are applicable even though the employer is insolvent, counsel for the Secretary recognized the empty formalism of the Secretary's interpretation of the Act (C.A. App. 35):

> "[I]t's a matter of whether you can collect it[;] they're liable for it. It's a matter, whether you can collect it[;] we're a creditor like other people[;] we can still get an injunction against [the insolvent] withholding [wage payments]. It's just a practical problem of collecting it."

[19] *See Donovan* v. *Brown Equipment and Service Tools, Inc.*, 666 F.2d 148, 157 (5th Cir. 1982). ("If, for example, the employer is bankrupt, an injunction would be in vain and the employer should not be threatened with citation for contempt for not doing what he is unable to do").

That is particularly true where the employer's asserted violation is due solely to insolvency.[20]

Furthermore, to invoke Section 15(a)(1) against a secured creditor to freeze inventory collateral (unless employees are paid first) effectively creates a federal lien superior to the security interest. See page 7, *supra*. It is, however, a lien whose existence depends on whether the Secretary decides to file suit under Section 15a(1). Only the Secretary can file such an action. See 29 U.S.C. § 211(a). One of the several anomalous aspects of the Secretary's interpretation of the FLSA in this case, therefore, is the implication that Congress intended to establish priority for employee wage claims, but only if the Secretary chooses to bring an action under Section 15(a)(1).

Even if, as the Secretary maintains, the FLSA is applicable in the context of an insolvent employer, there is no basis whatever in the language or structure of the Act for the Secretary's further assertion that in adopting Section 15(a)(1) of the Act Congress intended that the wage claims of "employees have priority" (C.A. App. 57) over the claims of secured creditors, without regard to state law. Whether an employee sues on his own behalf or the Secretary files suit under Section 15(a)(1) of the Act, the employee is "a creditor like other people" (note 18, page 17, *supra*), and is entitled to no greater priority than is provided under applicable state law.

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[20] As passed by the Senate, the FLSA defined "person" to include a "receiver, trustee, trustee in bankruptcy, or liquidating or reorganizing agent." Conference Report, reprinted, 83 Cong. Rec. 9250 (June 14, 1938). The House definition did not, *id.* 9252, and the conferees adopted the House definition. *Id.* at 9253. Without more, the unexplained omission of the specific reference to trustees in bankruptcy and similar persons proves nothing. Here, however, the omission tends to confirm what is apparent from the language and structure of the FLSA, namely, that Congress' primary concerns were the wages and hours of the employees of ongoing businesses.

B. The Legislative History of the FLSA Confirms That Section 15(a)(1) Was Not Intended to Preempt State Law Governing the Priority of Creditors' Claims Against Insolvents.

Nothing in the legislative history of the FLSA evidences any Congressional intent to preempt state creditors' rights law. Moreover, the legislative history is clear that Congress did not intend Section 15(a)(1) to be used against any innocent purchaser of hot goods, such as Citicorp.

1. The sole purpose of the FLSA was to establish minimum regular and overtime wage rates.

Congress' limited purpose. The Fair Labor Standards Act of 1938 had one purpose: to establish decent wages and hours for American workers.[21] In enacting the FLSA, Congress intended "to correct and as rapidly as practicable to eliminate," 29 U.S.C. § 202(b), "*labor conditions* detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and [the] general well-being of workers," 29 U.S.C. § 202(a) (emphasis added). More specifically, the Act "was designed to raise substandard wages and to give additional compensation for overtime work as to those employees within its ambit, thereby helping to protect this nation 'from the evils and dangers resulting from

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[21] The substantive provisions of the FLSA reflect its limited purpose only to establish "rudimentary" wage and hour standards for employees. President Roosevelt's Message to Congress, reprinted, 81 Cong. Rec. 4960, 4961 (May 24, 1937). Section 6 of the Act fixed a floor for wages. In the first year, the minimum wage rate was 25 cents per hour; the next year the minimum increased to 30 cents per hour, and within seven years the minimum hourly wage rate for covered employees was to be 40 cents per hour. 52 Stat. 1062-1063. Similarly, Section 7 established a gradually declining regular workweek, and prescribed premium wage rates for hours worked in excess of the regular workweek. 52 Stat. 1063-1064.

wages too low to buy the bare necessities of life and from long hours of work injurious to health.' "[22]

President Roosevelt's May 24, 1937 Message to Congress urging adoption of wage and hour legislation identified both the problem and the basic solution (81 Cong. Rec. 4960):

> "Our nation so richly endowed with natural resources and with a capable and industrious population should be able to devise ways and means of insuring to all our able-bodied working men and women a fair day's pay for a fair day's work. A self-supporting and self-respecting democracy can plead no justification for the existence of child labor, no economic reason for chiseling workers' wages or stretching workers' hours."

"Chiselers," those employers who paid their workers starvation wages and demanded inhuman hours, were the problem. The solution was: "a fair day's pay for a fair day's work."

Congress found that millions of Americans were being paid less than 40 cents per hour, and being required to work far in excess of 40 hours per week.[23] The "limited" objective of the FLSA to address only the most extreme and oppressive labor conditions (*i.e.*, starvation wages

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[22] *United States* v. *Rosenwasser*, 323 U.S. 360, 361 (1945) (citation omitted); *see Rutherford Food Corp.* v. *McComb*, 331 U.S. 722, 727 (1947); *Donovan* v. *Agnew*, 712 F.2d 1509, 1517 (1st Cir. 1983).

[23] *See, e.g.*, S. Rep. No. 884, 75th Cong., 1st Sess. 4 (July 6, 1937); 81 Cong. Rec. 7648-7649 (July 27, 1937) (statement of Sen. Black); 82 Cong. Rec. 1390 (Dec. 13, 1937) (statement of Rep. Norton) (less than 19 cents per hour); 82 Cong. Rec. 1393 (Dec. 13, 1937) (statement of Rep. Welch) ($4-5 per week); 83 Cong. Rec. 9175 (June 14, 1938) (statement of Sen. Chavez) (12 cents per hour); 83 Cong. Rec. 9257 (June 14, 1938) (statement of Rep. Welch) ($3 per week, 60 hour weeks); 83 Cong. Rec. 9261-9262 (June 14, 1938) (statement of Rep. Schneider).

and sweatshops) was emphasized throughout the debate (82 Cong. Rec. 1395 (Dec. 13, 1937) (statement of Rep. Randolph) (emphasis added)):

> "Congress is . . . engaged in establishing for that class of workers who stand in need of them decent working conditions with respect to hours and wages. To this end the Black-Connery Fair Labor Standard Act is before us with *the sole purpose and aim of raising existing wages in the lower wage groups so as to attain as rapidly as possible and practicable a minimum wage of 40 cents an hour and a maximum workweek of not more than 40 hours.*"[24]

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[24] *See, e.g.*, S. Rep. No. 884, 75th Cong., 1st Sess. 4 (July 6, 1937) ("a start should be made . . . to protect this Nation from the evils and dangers resulting from wages too low to buy the bare necessities of life and from long hours of work injurious to health"); H.R. Rep. No. 1452, 75th Cong., 1st Sess. 9 (Aug. 6, 1937) ("only attempts in a modest way to raise the wages of the most poorly paid workers and to reduce the hours of the most overworked"); H.R. Rep. No. 2182, 75th Cong., 3d Sess. 6 (April 21, 1938) ("establishes a floor for wages, and a ceiling for hours, and abolishes child labor"); 81 Cong. Rec. 7648 (July 27, 1937) (statement of Sen. Black) ("provides a method of obtaining the objective of minimum wages and maximum working hours"); *id.* 7649 ("minimum wage sufficient to prevent [an employee] from dying from slow undernourishment and slow starvation); *id.* 7651 ("intended to prevent . . . the payment of wages which are below a necessary subsistence level"); *id.* 7658-7659 (Senate committee unanimously agreed to limit the bill strictly to minimum wages, maximum hours, and child labor"); Senator Black, "Wide Benefits Seen in Wage and Hour Legislation," *New York Times*, July 25, 1937, reprinted, 81 Cong. Rec. 774? (the bill "deals with labor conditions only"); President F.D. Roosevelt's Message to Congress, Nov. 15, 1937, reprinted, 82 Cong. Rec. 11 ("protect workers unable to protect themselves from excessively low wages and excessively long hours"); 82 Cong. Rec. 1390 (Dec. 13, 1937) (statement of Rep. Norton) ("aims to establish only the basic wage and hour levels"); *id.* 1392 ("a cautious step . . . toward the removal of oppressive wage and hour conditions"); 83 Cong. Rec. 9258 (June 14, 1938) (statement of Rep. Randolph) ("designed to bring up a little the wages at the bottom of the scale and regulate also the hours for

The problem Congress addressed in the FLSA was that employees were being paid "excessively low wages" and being required to work "excessively long hours" by their "chiseling" employers—not collection problems caused by insolvency.[25] The Fair Labor Standards Act was intended to address "labor conditions only," 81 Cong. Rec. (July 28, 1937); it was "strictly" limited to wage, hour, and child labor standards, 81 Cong. Rec. 7658-7659 (July 27, 1937) (statement of Sen. Black, sponsor and floor manager of the Senate bill and chairman of the Senate Committee on Education and Labor). An insolvent employer's inability to pay agreed wages in excess of the statutory minimum is irrelevant to the problem at which the FLSA was directed. The Act simply was not intended to address the consequences of an employer's insolvency and certainly was not intended to supersede other well-established creditors' rights statutes or the Bankruptcy Act.

Three undisputed facts make it inconceivable that Congress actually considered creating a "secret" trust or lien

the needy and underpaid workers of this country"); 83 Cong. Rec. 9260 (June 14, 1938) (statement of Rep. Schneider) (the bill "will go a long way to end the exploitation of the poorest paid, the hardest worked, and the most defenseless toilers"); 83 Cong. Rec. 9264 (June 14, 1938) (statement of Rep. Keller) ("purpose is to establish and maintain better national labor standards—not the standards which we hope labor may eventually and should attain and enjoy [through collective bargaining]—but minimum standards below which labor cannot be compelled to work and live"); *see generally Fair Labor Standards Act of 1937, Joint Hearings Before the Senate Committee on Education and Labor and the House Committee on Labor on S. 2475 and H.R. 7200*, 75th Cong., 1st Sess. (1937) (*"1937 Joint Hearings"*) 30, 33, 38, 39, 47, 55, 61, 74 (statement of Asst. Attorney General Robert H. Jackson); *id.* 173-174, 180-181 (statement of Secretary of Labor Frances T. Perkins).

[25] *See* H.R. Rep. 1452, 75th Cong., 1st Sess. 8 (Aug. 6, 1937); H.R. Rep. No. 2182, 75th Cong., 3d Sess. 6 (Apr. 21, 1938); 81 Cong. Rec. 7672 (July 27, 1937) (statement of Sen. Walsh).

for employee wage claims superior to a perfected security interest in inventory. First, as discussed (pages 19-22, *supra*), the sole limited purpose of the Act was to prevent chiselers from paying substandard wages.[26] Second, in 1938 there was little reason to consider potential conflicts between wage claims and the claims of creditors with interests in inventory collateral, because inventory and accounts receivable financing was in its infancy.[27] And third, Congress acted in 1938 against a substantial backdrop of state legislation and common law governing employee wage liens and the relative priority of all creditors, including unpaid wage earners. In the absence of solid evidence that Congress actually intended to preempt those laws, such an intent cannot be presumed. See pages 38-41, *infra*.[28]

[26] Three days before the FLSA became law, the same Congress amended the Bankruptcy Act of 1898. The Chandler Act of 1938, 52 Stat. 840 (1938). As amended, the Bankruptcy Act continued "the general purpose of Congress to . . . safeguard interests under liens perfected before bankruptcy," and continued to recognize the validity of prior perfected liens against unsecured claims entitled to priority under the Bankruptcy Act. *Goggin* v. *Division of Labor Law Enforcement of California*, 336 U.S. 118, 126-127 & n.8 (1949). Wage claims, entitled to second priority under the 1938 amendment to the Bankruptcy Act, remained junior to secured creditors. *See generally City of Richmond* v. *Bird*, 249 U.S. 174, 174-175 (1919); 3 *Collier on Bankruptcy* ¶ 507.[02] at 507-16 (15th ed. 1986) ("Only after the discharge of valid liens and encumbrances are assets available for distribution to priority claimants").

[27] *See generally* 1 G. Gilmore, *Security Interests in Personal Property* 128-145 (Factor's Lien Act); *see also id.* at 33-47 (chattel mortgages), 124-127 (Uniform Trust Receipts Act).

[28] Furthermore, if Congress had focused on these issues, the likelihood that it would have attempted to preempt state law is small. When Congress considered the FLSA, there was substantial uncertainty as to whether this Court would sustain Commerce Clause legislation prescribing minimum wage, overtime, and child labor standards. *Compare Carter* v. *Carter Coal Co.*, 298 U.S. 238 (1936); *Schechter Poultry Co.* v. *United States*, 295 U.S. 495 (1935); *Hammer* v. *Dagenhart*, 247 U.S. 251 (1918), *with NLRB*

Congress' concern about competition. The court of appeals' assertion that enforcing Section 15(a)(1) against a secured creditor serves any Congressional purpose to protect business against competition from goods produced under substandard conditions is wrong. Pet. App. 6a-7a, 10a. The basis for Congress' exercise of jurisdiction under the Commerce Clause was its finding that the existence of substandard "labor conditions" in industries "engaged in commerce or in the production of goods for commerce . . . . (1) causes commerce and the channels and instrumentalities of commerce to be used to spread and perpetuate such labor conditions among the workers of the several States; (2) burdens commerce and the free flow of goods in commerce; (3) constitutes an unfair method of competition in commerce; (4) leads to labor disputes burdening and obstructing commerce and the free flow of goods in commerce; and (5) interferes with the orderly and fair marketing of goods in commerce." 29 U.S.C. § 202(a).[29]

The court of appeals confused the mechanism for enforcement (and the jurisdictional basis) of the FLSA with its purpose. The sole purpose of the FLSA was to improve the conditions under which Americans worked by raising wages and reducing hours. Congress was concerned about competitors only to the extent that competition from "chiselers" had the effect of driving wages

v. *Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1937); *see also Fair Labor Standards Act of 1937, Joint Hearings Before the Senate Committee on Education and Labor and the House Committee on Labor on S. 2475 and H.R. 7200*, 75th Cong., 1st Sess. (1937) ("*1937 Joint Hearings*") 1-89 (statement of Asst. Attorney General Robert H. Jackson). At that time, far more difficult constitutional issues would have been raised unnecessarily by an attempt to modify the priority of claims of creditors of insolvent debtors not in bankruptcy.

[29] *See, e.g., Maryland* v. *Wirtz*, 392 U.S. 183, 188-193 (1968); *United States* v. *Darby*, 312 U.S. 100, 109-110, 122 (1941).

down.[30] As Senator Black explained, "[l]ow wages control the wage scale, not high wages." 81 Cong. Rec. 7649 (July 27, 1937). The reference to "competition" in Congress' finding and declaration of policy reflects the attempt to bring the prescription of wages and hours within Congress' constitutional power to regulate interstate commerce, and to invoke every "hopeful approach to constitutionality" for prescription of wages, overtime, and child labor standards.[31]

[30] *See e.g.*, H.R. Rep. No. 1452, *supra*, at 9 (Labor Standards Board given power "to prevent competing, chiselling employers from undercutting decent, minimum wage standards or from stretching decent maximum-hour standards"); H.R. Rep. No. 2182, *supra*, at 6-7 ("No employer . . . need fear that he will be required by law to observe wage and hour standards higher than those applicable to his competitors. No employee . . . need fear that the fair labor standards maintained by his employer will be jeopardized by oppressive labor standards maintained by those with whom his employer competes"); 81 Cong. Rec. 7651 (July 27, 1937) (statement of Sen. Black) (the bill withdraws from "competitive conditions the wage level necessary for a person to live on"); *1937 Joint Hearings* 7, 60, 71 (statement of Asst. Attorney General Robert H. Jackson); *id.* 175, 178, 180, 183-184 (statement of Secretary of Labor Frances T. Perkins); *see generally Tony & Susan Alamo Foundation* v. *Secretary of Labor*, 471 U.S. 290, 302 (1985).

[31] As then Assistant Attorney General Robert H. Jackson explained, the draftsmen of the FLSA had attempted "to consolidate in a single bill all hopeful approaches to constitutionality, each complete in itself, so that if one or more falls at the hands of the Courts, we will not be left for an interval while a new bill is being adopted." *1937 Joint Hearings* 2; *see id.* 50-53, 85. Senate Bill 2475, Section 7(a), one of the predecessors to Section 15(a)(1) of the FLSA, was based on Justice Holmes' dissent in *Hammer* v. *Dagenhart*, 247 U.S. 251 (1918). *Id.* 58. If, as the administration hoped (*e.g.*, Roosevelt's May 24, 1937, Message to Congress), this Court accepted Justice Holmes' analysis and overruled or distinguished *Hammer* v. *Dagenhart*, the minimum wage and overtime provisions could be enforced through Section 15(a)(1) by prohibiting shipment or sale in interstate commerce of goods produced under substandard conditions, if all other "approaches to constitutionality" failed.

If Congress had sought to protect business against competition from goods produced under substandard conditions, enforcing Section 15(a)(1) against a secured creditor would not further that purpose. An employer-debtor's cost of production (including wages) is totally irrelevant to the foreclosing creditor, whose only interest is to sell the inventory at the best possible price to recover a loan, not to sell the goods cheaply to increase its share of the market. Compare Pet. App. 14a-15a.

2. Section 15(a)(1) was never intended to be invoked against innocent persons who acquire hot goods.

a. *Section 15(a)(1) as enacted in 1938.* The specific history of Section 15(a)(1) demonstrates that Congress broadly proscribed the sale of hot goods by "any person" to avoid circumvention of the substantive provisions of the Act by "chiselers" and those persons working in concert with them. Moreover, the history of the Act makes it plain that the "any person" language of Section 15(a)(1) was never intended to make secured creditors or other innocent, good faith purchasers of hot goods responsible for the wages of a seller's employees. The Secretary's position to the contrary is implausible, at best.

History of Section 15(a)(1). Consistent with the limits of the Commerce Clause, as understood in 1938, Section 15(a)(1) was intended to establish a mechanism for enforcing the minimum wage and overtime standards of the FLSA against *employers* throughout the chain of production and distribution of goods in interstate commerce. Limiting the reach of Section 15(a)(1) to offending "employers," however, would have provided an obvious and ready means of circumventing the substantive provisions of the Act. Accordingly, Congress proscribed the sale by "any person" of goods produced under substandard conditions, to reach the offending employer and any other culpable parties in possession of hot goods.

Assistant Attorney General Robert Jackson's explanation during the joint congressional hearings in 1937 of the intended operation of the legislation makes it clear that if Section 15(a)(1) had proscribed shipment or sale in interstate commerce only by employers who violated the wage and hour provisions, "the law would be a nullity, because they could farm out the parts of the work that they wanted to do under substandard conditions." *1937 Joint Hearings* 87.[32] The subcontractor would produce goods under substandard conditions and sell them within a state to its principal, who then would incorporate the goods into a finished product for shipment or sale in interstate commerce. See *1937 Joint Hearings* 85-87.[33] If Section 15(a)(1) had been limited to prohibiting shipment or sale only by the offending employer, it would not have prevented the shipment of the finished product by the principal. See id. Nor would a prohibition against interstate shipment and sales have been applicable to the subcontractor whose goods were intended for sale only within a state.[34] For that reason, Section 15(a)(1) prohibits "any person" from selling or shipping goods produced under substandard labor condi-

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[32] The "sweatshop" was one of the evils Congress hoped to eliminate by passage of the FLSA. "By the sweatshop is ordinarily meant a subcontractor; that is, a contractor who takes work from a principal and takes it out to do under contract in a shop which may be in his home or may be in hired premises." *1937 Joint Hearings* 196 (statement of Secretary of Labor Frances T. Perkins).

[33] *See also Rutherford Food Corp.* v. *McComb*, 331 U.S. 722 (1947) (rejecting contract labels in determining whether workers are "employees" or "independent contractors" for purposes of the FLSA).

[34] *See also* 83 Cong. Rec. 7399-7400 (May 24, 1938) (statement of Rep. Martin) (criticizing the child labor standards enforcement provisions, which authorized the Chief of the Children's Bureau of the Department of Labor to proceed against only producers, manufacturers, and dealers, Sections 12, 15(a)(4), 52 Stat. 1067, 1068, and therefore were subject to circumvention).

tions, "and the fact that you change the title by selling them from A to B before they go into interstate commerce does not affect it." *1937 Joint Hearing* 87.[35]

Thus, the hot goods provision was aimed at the chiseling employers who paid starvation wages and demanded inhuman hours of their employees. Congress had no desire to punish parties who acquired hot goods in good faith, without participation in any scheme to circumvent the substantive wage and hour provisions of the Act.[36] Section 15(a)(1) was not intended to nullify state lien statutes by establishing a federal wage lien.

Innocent purchasers.[37] Unlike the Secretary, Congress clearly recognized the distinction between "chiselers" and innocent purchasers when the FLSA was under consideration. The legislative history reflects the tension between drafting the Act broadly to avoid circumvention and avoiding the creation of a trap for innocent purchasers, but no one questioned the self-evident proposition that no innocent purchaser should be held responsible for the sins of his seller.[38]

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[35] *See, e.g., Hamlet Ice Co.* v. *Fleming*, 127 F.2d 165, 167 (4th Cir.), *cert. denied*, 317 U.S. 634 (1942) (rejecting intrastate seller's attempt to avoid FLSA).

[36] *See, e.g., 1937 Joint Hearings* 74-75 (statement of Asst. Attorney General Robert H. Jackson); *id.* 936-937, 941 (statement of George H. Davis, President, Chamber of Commerce of the United States).

[37] Under general commercial law principles, a secured creditor is a "purchaser." *See* Uniform Commercial Code §§ 1-201(32), (33).

[38] The Secretary cannot suggest that Section 15(a)(1) is a forfeiture provision, requiring relinquishment of the goods to the government. *See* note 11, page 9, *supra*; *see also* note 9, page 8, *supra*. During the hearings on the FLSA, Representative Thomas suggested that perhaps the proposed Labor Standards Board should be authorized to "go in and seize and forfeit [hot goods] wherever found, and by some proper provision, take care of the innocent pur-

As introduced and reported out of committee in both Houses, the FLSA contained three provisions that clearly evidence Congress' concern that the breadth of Section 15(a)(1) should not be a trap for innocent parties. First, the term "goods" was defined to exclude "goods after their delivery into the actual physical possession of the ultimate consumer . . . other than a producer, manufacturer, or processor." 82 Cong. Rec. 1511-1512 (Dec. 14, 1937). Second, the proposed Labor Standards Board was authorized to issue "certificates of compliance" with the wage and hour standards of the Act: no innocent purchaser of goods from the holder of such a certificate would have been subject to prosecution by the Labor Standards Board under the Act.[39] On the floor of the Senate, the certificate of compliance provision was modified to permit a good faith purchaser to rely on a written representation of compliance from the seller. 81 Cong. Rec. 7891 (July 30, 1937) (statement of Sen. Murray).[40] Third, the Labor Standards Board was au-

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chaser or the innocent holder of the goods where he did not buy these goods that were produced under subnormal conditions knowingly." *1937 Joint Hearings* 70. Mr. Jackson acknowledged that forfeiture had proved effective in other contexts, but explained that such a provision in the FLSA might be problematic "from the point of view of constitutionality." *Id. See generally United States* v. *U.S. Coin & Currency*, 401 U.S. 715, 720-722 (1971); *United States* v. *One Ford Coach*, 307 U.S. 219, 236-237 (1939). Representative Thomas dropped the suggestion.

[39] 81 Cong. Rec. 7891 (July 30, 1937) (statement of Sen. Murray); S. Rep. No. 884, *supra*, 8; *see also* H.R. Rep. No. 1452, *supra*, at 18.

[40] Like the certificate of compliance provision, the amendment was phrased to protect an innocent purchaser from prosecution by the Labor Standards Board (81 Cong. Rec. 7891):

> "No person other than the producer shall be prosecuted for the transportation, shipment, delivery, or sale of unfair goods who has secured a representation in writing from the person by whom the goods transported, shipped, or delivered were

thorized to exempt goods from the prohibition of Section 15(a)(1), where "every person having a substantial proprietary interest in the goods had no reason to believe that any substandard condition existed in the production of the goods." [41]

In the House, the bill was resubmitted to committee for reasons unrelated to the protection afforded good faith purchasers.[42] On resubmission, the House committee eliminated the enforcement responsibilities of the proposed Labor Standards Board and, accordingly, omitted both the immunity from prosecution provision and the exemption authority.[43] Omission of these provisions in the House reflected the desire to simplify administra-

produced . . to the effect that such goods were not produced in violation of any provision of this act."

The reason for the modification was to reduce the burden of administering the Act. *Id.* There was no dispute as to whether an innocent purchaser should be subject to injunction under the predecessor of § 15(a)(1); that was self-evident. The bill initially reported by the House committee included the provision, as amended on the Senate floor. H.R. Rep. No. 1452, *supra*, at 18.

[41] S. Rep. No. 884, *supra*, 9; H.R. Rep. No. 1452, *supra*, 19. When an offending employer had a proprietary interest in the goods, the Labor Standards Board could exempt the goods only if the employer paid the wages due. S. Rep. No. 884, *supra*, at 9 ("in order to secure . . . exemption, provision must be made for *the payment of reparations by every employer* having a proprietary interest in the goods *who failed to maintain the required wage or hour standard*") (emphasis added); H.R. Rep. 1452, *supra*, at 19; *1937 Joint Hearings* 62. If the employer was financially unable to make the required wage payments, the provision would have been inapplicable. Thus, Congress clearly did not have in mind the situation of any insolvent employer.

[42] None of the provisions relating to good faith purchasers was criticized during the debate on the bill initially reported by the House committee.

[43] *See generally* H.R. Rep. No. 2182, 75th Cong., 3d Sess. 11, 12 (Apr. 21, 1938). The House committee also dropped the definition of the term "goods."

tion of the Act and avoid establishing yet another bureaucracy. The omissions are not mentioned in the House committee report, and there was no discussion concerning them on the floor.

The Conference Committee compromise established the Wage and Hour Division within the Department of Labor. Responsibility for enforcing the Act was vested in the Administrator of the division, thereby avoiding creation of a separate Labor Standards Board. Conference Report, reprinted, 83 Cong. Rec. 9246-9255 (June 14, 1938). The conference bill did not contain either the immunity from prosecution provision or the exemption authority provision, although the definition of "goods" in the Senate bill was retained. There is no evidence that the omission of these provisions reflected an intention to punish innocent purchasers of hot goods. Given the manifest concern (evident in the earlier versions of the bill) to avoid subjecting innocent purchasers to injunction under Section 15(a)(1), Congress' silence is deafening. "'We can be certain that there would have been . . . debate concerning consequences so wasteful, so inimical to purposes previously deemed important, and so likely to arouse public outrage.'" [44] Such a dramatic change of policy surely would have prompted at least one comment. There was none.

Incredibly, the Secretary has suggested in this Court that Congress' silent omission of the exemption authority provision reflected a "deliberate[]" decision to make secured creditors and other innocent parties responsible for the wrongs of others.[45] In light of the legislative

[44] *Kelly* v. *Robinson*, 107 S. Ct. 353, 362 (1986), quoting *TVA* v. *Hill*, 437 U.S. 153, 209 (1978) (Powell, J., dissenting).

[45] Resp. Br. in Opp. 10-11; *see also* Brief for the Secretary of Labor, Nos. 85-5249, 85-5252 (6th Cir.) 30-34. The Sixth Circuit correctly rejected the argument. Pet. App. 10a-11a n.10. The Secretary properly does not suggest that the omission of the immunity from prosecution provision implies any intention to punish innocent purchasers.

history of the Act, the only plausible inference that can be drawn from the omission of the exemption authority is that Congress reasonably concluded the provision was unnecessary. Only the Administrator of the Wage and Hour Division was authorized to enforce Section 15(a)(1). In any case where an exemption would have been appropriate, the agency could accomplish the same result by not seeking an injunction. If, contrary to common sense and Congress' manifest intention, the agency proceeded against an innocent purchaser under Section 15(a)(1), general principles of equity would permit a court to deny relief.[46]

b. *Section 15(a)(1) as amended in 1949.* The history of the only amendment to Section 15(a)(1) since 1938 reveals that Congress rejected the basic premise of the Secretary's argument.[47] In 1949 Congress amended the hot goods provision to correct a specific error in the Administrator's interpretation of the Act that fore-

[46] *See generally Weinberger* v. *Romero-Barcelo*, 456 U.S. 305, 313 (1982) ("The grant of jurisdiction to ensure compliance with a statute hardly suggests an absolute duty to do so under any and all circumstances, and a federal judge sitting as chancellor is not mechanically obligated to grant an injunction for every violation of law."); *Hecht Co.* v. *Bowles*, 321 U.S. 321 (1944); *cf. Shultz* v. *Factors, Inc., supra*; *Wirtz* v. *Powell Knitting, supra. See also Amendments to the Fair Labor Standards Act of 1938: Hearings Before the House Committee on Education and Labor* on H.R. 2033, 81st Cong., 1st Sess. (1949) ("*1949 House Hearings*") 94-95 (statement of Harold C. Nystrom, Chief Interpretation Branch, Office of the Solicitor, Department of Labor) (discussing provisions of the Act governing child labor standards).

[47] Congress amended Section 15(a)(1) in 1949 by adding the following language (63 Stat. 919):

> "except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements [of the Act], and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful."

shadowed in some respects the Secretary's more extreme position in this case that Section 15(a)(1) was intended to require secured creditors to supervise the payroll practices of their debtors (see Resp. Br. in Opp. 14). The Administrator had asserted that certain ordinary commercial purchasers would be subject to injunction under Section 15(a)(1), if they failed to "police" their vendors' compliance with the wage and hour provisions of the FLSA.[48] The Administrator indicated that unless these purchasers included clauses in their contracts requiring their vendors to comply with the substantive provisions of the FLSA and "spot checked" their vendors' payroll practices "to detect any 'hot goods' in the making," they could not be considered innocent, good faith purchasers and, therefore, would be subject to prosecution under Section 15(a)(1).[49] According to the Administrator, "[t]his

[48] "Insurance Against 'Hot Goods'" reprinted, BNA, *Wage and Hour Manual* 937-939 (Cum. 1945). The Administrator noted that the problem had arisen most frequently "in connection with purchases of wood products by lumber concentration yards, chemical companies, pulpwood and paper companies, and other large users of timber products." *Id.* 937-938.

[49] *Id.* 938. Like the Secretary today, the Administrator attempted to justify his position by arguing that purchasers who monitored certain practices of their sellers should also check for compliance with the FLSA (*id.*):

> "Most chemical companies, lumber dealers, and pulpwood companies, which buy large quantities of wood, do not deal at arm's length with their suppliers. They employ woodsmen, buyers, foresters, and other representatives who are constantly in the field checking the operations of their contractors for various purposes—to see whether proper forestry practices are being observed; to see that the price paid for the wood is not too high; to see whether the contractor is desirable in other respects for future business dealings. There is no reason why these men should not at the same time 'spot check' the contractors' operations to see whether they are complying with the wage and hour provisions of the contract and to detect any 'hot goods' in the making."

Compare Resp. Br. in Opp. 14 ("lenders, including petitioner in this case, routinely monitor their borrowers' activities closely to

is the kind of 'policing' we have a right to expect . . ." in light of Section 15(a)(1). *Wage and Hour Manual* 938.

Unlike the Secretary in this case, however, the Administrator acknowledged the distinction between an innocent purchaser and the target of the FLSA, namely, the chiseler, "the man who has *failed to pay his employees* in accordance with the provisions of the Act *notwithstanding that he was financially able to do so." Wage and Hour Manual* 938 (emphasis added). Moreover, although mistaken as to what constituted an innocent, good faith purchase, the Administrator at least recognized that Congress never intended Section 15(a)(1) to be invoked against a person who acquired hot goods, innocently and in good faith. See id. 938-939.

Businessmen threatened with the prospect of enforcement action under the hot goods provision if they failed to "police" their vendors' compliance with the FLSA brought the Administrator's statement to the attention of Congress during the hearings preceding the adoption of the 1949 amendment to Section 15(a)(1).[50]

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ensure that the borrowers comply with both public law and their obligations to other creditors, lest a legal bar or a superior lien (for taxes, to a supplier, or to employees) bar the exercise of the lender's rights.").

[50] *See, e.g., Fair Labor Standards Act Amendments of 1949: Hearings Before a Subcomm. of the Senate Comm. on Labor and Public Welfare on S. 58, S. 67, S. 92, S. 105, S. 190, S. 248, S. 653*, 81st Cong., 1st Sess. (1949) ("*1949 Senate Hearings*") 882-883, 890, 898 (statement of John M. Higgins, Southern Pine Industry Committee); *Fair Labor Standards Act Amendments: Hearings Before a Subcomm. of the Senate Comm. on Labor and Public Welfare on S. 49 et al.*, 80th Cong., 2d Sess. (1948) ("*1948 Senate Hearings*) 580, 609 (statement of Joseph B. Fraser, Southern Pine Industry Committee); *see generally 1949 Senate Hearings* 943, 947 (statement of Thomas O. Moore, American Cotton Manufacturers Association); *id.* 1098 (statement of Chamber of Commerce, Philadelphia, Pennsylvania); *Amendments to the Fair Labor Standards Act of 1938: Hearings Before the House Comm. on Education and Labor on H.R. 2033*, 81st Cong., 1st Sess. (1949).

Industry representatives recognized that the Administrator's enforcement policy was inconsistent with the intended use of Section 15(a)(1).[51] Congressmen unequivocally confirmed that the Administrator's reading of Section 15(a)(1) swept far too broadly (*1949 House Hearings* 688, 690-691):

> "[Rep.] Barden: [W]e did not conceive of the Administrator using [Section 15(a)(1)] as he did.
>
> . . . . .
>
> "[Rep.] Jacobs: I do not personally think that a man who bought [the goods] innocently should be prosecuted.
>
> "[Rep.] Braden: We do not either . . .
>
> "[Rep.] Jacobs: The man who did wrong is the one they should get after.
>
> "[Rep.] Barden: That is right. That is what we intended. That is what we wanted to get.
>
> "[Rep.] Burke: In other words, you do not want to make the purchaser the policeman?
>
> "[Rep.] Barden: You do not want to punish innocent people." [52]

("1949 House Hearings") 660-661, 688-691 (statements of R.M. Eagle, John M. Higgins, Arthur Temple, Southern Pine Industry Committee).

[51] *1949 Senate Hearings* 898 (statement of John Higgins, Southern Pine Industry Committee) ("Congress probably did not intend that this should be the effect of [§ 15(a)(1)]."); *see 1949 House Hearings* 688 (statement of John Higgins, Southern Pine Industry Committee) ("No doubt that provision [§ 15(a)(1)] was put into the law to prevent your unscrupulous operator [*i.e.*, the chiseler] from just violating [the wage and hour requirements] wholesale."); *see also 1937 Joint Hearings* 936-937, 941 (statement of George H. Davis, President, Chamber of Commerce of the United States).

[52] For the convenience of the Court, relevant passages from the *1949 House Hearings* are reproduced in an appendix to this brief.

Thus, it was as clear in 1949 as it had been in 1938 that Section 15(a)(1) was not intended to be invoked against innocent purchasers. The Administrator's statement of enforcement policy revealed that he had misinterpreted the intended scope of Section 15(a)(1). Congress, therefore, made explicit what should have been obvious to all, and rejected the Administrator's stated enforcement policy.

The 1949 amendment permits a good faith purchaser in the ordinary course of business to avoid any potential application of Section 15(a)(1) by simply having the seller stamp or print on its invoice that its employees have been paid in accordance with the minimum wage and hour provisions. See 29 C.F.R. § 789.4 (1984).[53] The 1949 amendment protects a good faith purchaser, without imposing any extraordinary obligation to "police" the payroll practices of his seller or "to detect any 'hot goods' in the making." "The requirement that [the purchaser] must have made the purchase in good faith is comparable to similar requirements imposed on purchasers in other fields of law, and is to be subjected to the test of what a reasonable, prudent man, acting with due diligence, would have done in the circumstances." Conference Rep. No. 1453, reprinted in *1949 U.S. Code Cong. & Admin. News* 2251, 2271.[54]

Congress responded in 1949 to the specific problem raised by the Administrator's stated enforcement policy, and confirmed what was manifestly implicit in the Act, as adopted in 1938, namely, that Section 15(a)(1) was never intended to be invoked against innocent purchasers.[55] In correcting the Administrator's erroneous interpretation of Section 15(a)(1) as to one group of innocent purchasers, Congress did not thereby broaden its intended scope, or endorse the Secretary's expansive notion of the intended reach of the provision in this case as to secured creditors or other innocent parties.[56] The legislative history of the 1949 amendment makes very clear that Congress was not carving out a narrow exception to the intended reach of Section 15(a)(1). Rather, it was correcting a particular misinterpretation and misapplication of the provision by the Administrator. Representative Barden's criticism in 1949 of the Administrator's interpretation of what Congress intended is also true of the Secretary's position today: "You cannot conceive of 435 sensible men doing that . . . . But [Congress] did

[53] Some purchasers already had adopted comparable practices in 1949. *See 1949 House Hearings* 684 (statement of John Higgins, Southern Pine Industry Committee). App. 1a, *infra*.

[54] *See* H. Rep. No. 267, 81st Cong., 1st Sess. 39 (Mar. 16, 1949).

[55] As discussed, (pages 29-30, *supra*), the bill passed by the Senate and the bill initially reported by the House committee, included a provision comparable to the 1949 amendment, which would have protected a good faith purchaser who relied on its seller's written representation of compliance. 81 Cong. Rec. 7891 (July 30, 1937) (statement of Sen. Murray); *see* H.R. Rep. No. 1452, *supra*, at 19. Given the history of the 1938 legislation, the omission of the provision in conference almost certainly reflected the belief that the provision was unnecessary. In the unlikely event the Administrator proceeded against an innocent purchaser, the courts of equity would deny relief. *See* note 46, page 32, *supra*. The Administrator's statement of enforcement policy, however, made it appropriate to eliminate the threat, and Congress did so.

[56] Congress had no reason to address the application of Section 15(a)(1) to secured creditors in 1949, because from 1938 to 1966 neither the Administrator nor anyone else suggested that the provision should apply to secured creditors. *See Wirtz* v. *Powell Knitting*, *supra*, 360 F.2d 733. It is particularly unlikely that, if the issue had been raised, Congress would have approved the application of Section 15(a)(1) to secured creditors. If a seller refuses to provide the written assurance of compliance necessary to meet the standards of the 1949 amendment or if doubt exists as to the reliability of the assurance, a commercial purchaser in the ordinary course of business generally can turn to alternative suppliers. A secured creditor has no such option. It defies reason to suggest that in adopting the 1949 amendment, Congress intended that the only innocent purchasers who should be subject to Section 15(a)(1) are secured creditors, who are essentially involuntary purchasers.

not conceive of the Administrator [or the Secretary] using that [provision] as he did." *1949 House Hearings* 689 (statement of Rep. Barden), App. 1a, *infra.*

C. The General Language of a Federal Statute Should Not Be Construed to Preempt State Law *Sub Silentio,* Unless Essential to Accomplish the Purposes of the Statute.

State laws governing creditors' rights reflect the judgments of state legislatures as to the appropriate degree of protection to be afforded unpaid employees of financially distressed corporations. The holding of the Sixth Circuit, effectively establishing a secret federal lien or trust for wage claims with priority over earlier perfected security interests and, presumably, other consensual, statutory, or judicial liens, nullifies the contrary policy judgments of state legislatures throughout the country. Under the circumstances of this case, where there is no evidence of any legislative intent to address the relative priority of creditors' claims against insolvent debtors, this Court should not construe Section 15(a)(1) to preempt state law. "Our Federalism," *Younger* v. *Harris,* 401 U.S. 37, 44 (1971), requires rejection of a construction of a federal statute that preempts an area traditionally governed by state law, unless essential to accomplish the purposes of the statute or Congress' intent is otherwise clear.

Article 9 of the Uniform Commercial Code has been adopted by the legislature of every state in the country (except Louisiana), and by Congress for the District of Columbia.[57] Under Article 9 secured creditors generally are entitled to satisfaction of their claims out of property in which they have a perfected security interest before the property can be used to satisfy the claims of

[57] *See United States* v. *Kimbell Foods, Inc.,* 440 U.S. 715, 732 n.28 (1979); *Slodov* v. *United States,* 436 U.S. 238, 257 n.22 (1978).

any unsecured creditors, including, for example, the claims of employees for unpaid wages.[58] Notoriety by notice filing is critical to the operation of Article 9, and to the underlying concept that a potential creditor should be able to determine the risks and the priorities of other creditors before extending credit. See, e.g., *United States* v. *Kimbell Foods, Inc.,* 440 U.S. 715, 739 n.42 (1979). With few exceptions, therefore, Article 9 avoids undisclosed and effectively undiscoverable secret liens or trusts that may defeat the claims of creditors with perfected security interests.[59]

In addition to Article 9 of the Uniform Commercial Code, there is a wide variety of state legislation specifically governing wage liens. See notes 60-62, *infra.* Much of this legislation antedates the Fair Labor Standards Act, and Congress doubtless was aware of it. The statutes reflect the many and varied policy judgments that state legislators have made in dealing with the difficult problems of who should be preferred to whom when there is not enough money to pay all the debts of an insolvent. For example, while some states extend protection to virtually all employees, others limit protection to employees in particular industries.[60] Other states limit the dollar

[58] *See* Uniform Commercial Code, §§ 9-201, 9-301(1), 9-312, 9-501 to 9-507; *see generally* White & Summers, *Handbook of the Law Under the Uniform Commercial Code,* 1030-1083 (2d ed. 1980).

[59] Mechanic's liens or repairmen's liens, which may take priority over a perfected security interest under Uniform Commercial Code § 9-310, are not "secret" in the sense in which the term is used here. Such liens are effective against a perfected security interest only if the goods are in the "possession" of the vendor. *E.g., Forrest Cate Ford, Inc.* v. *Fryar,* 62 Tenn. App. 572, 577, 465 S.W.2d 882, 884 (1970); *see generally Note, The Priority Rules of Article Nine,* 62 Cornell L. Rev. 834, 907-918 (1977); Note, *Nonconsensual Liens Under Article 9,* 76 Yale L.J. 1649, 1656 & n.34 (1967).

[60] *Compare* Pa. Stat. Ann. tit. 43, § 221 (Purdon 1964) (virtually all employees) *with* Ala. Code § 35-11-90 (1977) (railroad em-

amount of the claims for which protection is provided; some impose no limitation.[61] Before Article 9 was adopted, some states arguably would have given priority to a wage lien over a previously perfected security interest; others clearly did not.[62]

Absent persuasive evidence that Congress intended to preempt these state laws governing the relative priority of creditors of insolvent corporations, the general language of a federal statute should not be construed to have such an effect.[63] "[T]he principal means chosen by the Framers to ensure the role of the States in the federal system lies in the structure of the Federal Government

ployees); Me. Rev. Stat. Ann. tit. 10, §§ 3201-4012 (1980 & 1985 Supp.) (miscellaneous specific categories); Miss. Code Ann. § 85-7-1 (1985 Supp.) (agricultural employees).

[61] *Compare* Cal. Civ. Code § 3061.5 (Deering 1985 Supp.) (agricultural laborers, two weeks earnings, 25% of value of severed crops, or 25% of sale proceeds, whichever is less); Del. Code Ann. tit. 10, § 4931 (1975) (New Castle County, $50 and one month); Minn. Stat. Ann. § 514.59 (West 1986 Supp.) ($1000 or 5 weeks net wages up to $3000, whichever is greater) *with* Alaska Stat. § 34.35.435 (1985) (clerk, accountant, bookkeeper, *et al.*); Ind. Code Section 32-8-24-1 (1986 Supp.)

[62] *Compare* Alaska Stat. § 34.35.435 (1985); Ark. Stat. Ann. Section 51-320 (1971); S.C. Code Ann. § 29-11-10 (1977); Tenn. Code Ann. § 66-13-101 (1982) *with* Del. Code Ann. tit. 8, § 300 (1975); Fla. Stat. Ann. § 713.58 (1986 Supp.); Ind. Code § 32-8-24-2 (1986 Supp.); Minn. Stat. Ann. § 514.59 (West 1986 Supp.); *see DiAngelo* v. *McCormick Bros., Inc.*, 168 A. 79 (Del. Ch. 1933); *Flynn-Harris-Bullard Co.* v. *Johnson*, 90 Fla. 654, 107 So. 358 (1925); *see also* Ga. Code Ann. § 44-14-380 (1982).

[63] *See, e.g., Louisiana Public Service Commission* v. *FCC*, *supra*, 106 S. Ct. 1899; *Philko Aviation, Inc.* v. *Shacket*, 462 U.S. 406, 409-411 & nn.2-4 (1983); *In the Matter of Gary Aircraft Corp.*, 681 F.2d 365, 368-372 (5th Cir. 1982) (Wisdom, J.), *cert. denied*, 462 U.S. 1131 (1983) (rejecting contention that Federal Aviation Act established federal priority scheme absent "strong reasons to believe that Congress intended to displace" state law in this area).

itself."[64] When generally-worded provisions of a federal statute are construed to supersede state policy judgments —without any evidence of consideration by Congress— the safeguards for federalism inherent in the structure of the national government cannot "perform[] as intended," *Garcia* v. *San Antonio*, *supra*, 469 U.S. 556.[65] "[T]he implications and limitations of our federal system constitute a major premise of all congressional legislation," and therefore Congress "will not be deemed to have significantly changed the federal-state balance . . . unless otherwise the purpose of the Act would be defeated."[66] The Secretary cannot satisfy the heavy burden of persuasion imposed by the "implications and limitations of our federal system" in this case.

The sole purpose of the FLSA to establish rudimentary wage and hour standards will not be impaired by rejecting the Secretary's position. The consequences of an employer's insolvency are far removed from the concerns that prompted enactment of the FLSA. The Act had nothing whatever to do with the priority of creditors'

[64] *Garcia* v. *San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 550 (1985); *see generally* H. Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 Colum. L. Rev. 543 (1954).

[65] Whatever doubt there may be as to whether those "safeguards" are sufficient, *see Garcia* v. *San Antonio*, *supra*, 469 U.S. 565-566 & n.9 (Powell, J., dissenting); *id.*, 469 U.S. 584, 587 (O'Connor, J., dissenting), construing the general language of a federal statute to supersede state laws on matters of primarily local concern without evidence that Congress ever considered, much less intended such a result, renders those safeguards wholly ineffective.

[66] *Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2121 & nn.32-33 (1986) (plurality opinion) (citations omitted); *see Kelly* v. *Robinson*, 107 S. Ct. 353, 361 & n.11 (1986), quoting Frankfurter, Some Reflections on the Reading of Statutes, 47 Colum, L. Rev. 527, 539-540 (1947); *Kirschbaum Co.* v. *Walling*, 316 U.S. 517, 520-522 (1942).

claims against insolvent employers, and the *Powell Knitting* rule has governed for 20 years without any apparent ill effect on the Secretary's administration of the Act or the achievement of the Act's purpose. Reaffirming that rule in this case will have no greater impact.

D. The Construction of the FLSA Adopted by the Sixth Circuit Improperly Repeals by Implication Other Federal Statutes.

When Congress has intended to supersede state law governing the priority of creditors' claims or to create secret trusts or liens to assure payment of particular creditors, it has done so explicitly, with due regard to the interests of both secured creditors and otherwise controlling state law.[67] The court of appeals' construction of Section 15(a)(1) produces irreconcilable conflicts between the FLSA and other federal statutes that specifically address the priority of wage claims and inventory security interests as well as the interests of other creditors. "It is, of course, a cardinal principle of statutory construction that repeals by implication are not favored."[68] As this Court recently reiterated, "where . . .

[67] *See Mahon* v. *Stowers*, 416 U.S. 100 (1974) (holding that Congress did not intend to establish a secret trust or lien to assure payment of cattlemen in the Packers & Stockyards Act, 7 U.S.C. § 181). In 1976, Congress amended the Packers & Stockyards Act to create a statutory trust on the proceeds of sale for unpaid cattlemen. 7 U.S.C. § 196. Similarly, in 1984 Congress explicitly created a statutory trust for the protection of vendors of certain agricultural commodities. Perishable Agricultural Commodities Act, 7 U.S.C. § 499e(c). *See also* Section 3466 Rev. Stat., 31 U.S.C. § 3713; Federal Tax Lien Act of 1966, 26 U.S.C. Sections 6321-6323 (priority dates from the filing of notice and is junior to prior perfected security interests).

[68] *Radzanower* v. *Touche Ross & Co.*, 426 U.S. 148, 154 (1976), quoting *United States* v. *United Continental Tuna Corp.*, 425 U.S. 164, 168 (1976); *see generally* 1A *Sutherland Statutory Construction* ¶ 23.10 at 346-354 (4th ed. 1985).

statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective."[69] Accordingly, the language and structure of the FLSA and the legislative history described above (pages 14-38, *supra*) are equally relevant here, because they demonstrate that Congress simply did not intend to address creditors' rights in enacting the FLSA.

Under the Bankruptcy Code, a trustee is obligated to liquidate the bankrupt's estate including inventory. The order of distribution of the proceeds is precisely described in the Bankruptcy Code. 11 U.S.C. § 507. Wage claims cannot lawfully be paid ahead of liens and costs of administration. "Only after the discharge of valid liens and encumbrances are assets available for distribution to priority claimants." 3 *Collier on Bankruptcy* ¶ 507.02 [2] at 507-16 (15th ed. 1986).[70] Under the Bankruptcy Code, wage claimants have third priority, but all "[a]ssets of a debtor in the trustee's hands are subject to all of the equities, liens, and encumbrances . . . that exist at the date of bankruptcy . . . ." Id. If a trustee in bankruptcy is a "person" within the meaning of the FLSA, however, he could be enjoined from selling inventory or from distributing proceeds as required by the Bankruptcy Code.

The same conflict existed under the Bankruptcy Act, as it existed in 1938. As explained (note 26, page 23, *supra*), the same Congress that adopted the FLSA also adopted the Chandler Act, which continued the protection afforded secured creditors under the bankruptcy laws. *Goggin* v.

[69] *Ruckelshaus* v. *Monsanto Co.*, 467 U.S. 986, 1018 (1984) (internal quotation marks omitted); *see Morton* v. *Mancari*, 417 U.S. 535, 551 (1974); *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 357 (1963).

[70] *See generally* 3 *Collier on Bankruptcy* ¶¶ 506.02, 507.02, 507.03 (15th ed. 1986); 2 G. Gilmore, *Security Interests in Personal Property* 1051 (1965); *see also Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730, 733 (2d Cir. 1966).

Division of Labor, supra, 336 U.S. 126-127 & n.8. A prior perfected secured creditor was entitled to be paid in full, before any payment of employee wage claims entitled to second priority under the bankruptcy law, as it existed in 1938.

The Federal Tax Lien Act of 1966, 26 U.S.C. §§ 6321, *et seq.*, establishes a lien on all the property of a delinquent taxpayer, and prescribes the relative priority between the tax lien and private creditors. The tax lien is enforceable by sale, subject to prior perfected security interests. Under the Secretary's theory, agents of the Internal Revenue Service would be unable to sell inventory or take the proceeds of the sale of inventory ahead of Ely employees' wage claims. Agents of the IRS are clearly within the phrase "any person" in the literal sense, but just as clearly were not intended to come within the scope of Section 15(a)(1). To the extent a taxpayer's property is insufficient to satisfy both employee wage claims and the tax claim, the federal tax lien is impaired. Congress' specific intention in creating the lien to assure collection of tax revenues would be thwarted.[71]

In the Packers and Stockyards Act, Congress provided that "livestock purchased by a packer in cash sales, and

[71] Further, because a federal tax lien is subordinate to the prior perfected security interest of a commercial lender, 26 U.S.C. § 6323 (a), (c), the Secretary's construction of the FLSA may produce unintended and highly undesirable "circular priority" problems. *See generally* 2 G. Gilmore, *Security Interests in Personal Property* 1020-1046 (1965). A federal tax lien is subordinate to the prior perfected security interest of a commercial lender, but the tax lien is superior to later unsecured wage claims. The employee wage claims (according to the Secretary) would be superior to the senior security interest. If this circularity of liens and claims existed when bankruptcy proceedings were initiated, the Secretary's interpretation of Section 15(a)(1) would also disrupt the Bankruptcy Code priority system, again contrary to Congress' clearly expressed intentions. *See generally* 3 *Collier on Bankruptcy* ¶ 507.03 (15th ed. 1986).

all inventories of, or receivables or proceeds from meat shall be held by such packer in trust for the benefit of all unpaid cash sellers of such livestock until full payment has been received by such unpaid sellers" (7 U.S.C. § 196(b)). Congress' specific intention under the Packers and Stockyards Act was to protect a seller of cattle at least in part from the consequences of a packer's insolvency. Under the Secretary's interpretation of the FLSA, however, an unpaid livestock vendor could be enjoined from recovering and selling his cattle or the products thereof whenever the defaulting packer had failed to pay his employees. In any case in which both the FLSA and the Packers and Stockyard Act apply, one or the other must give way. Congress' purpose in enacting the Packers and Stockyards Act cannot be accomplished, if, as the Secretary maintains, "employees have priority" under the FLSA (page 7, *supra*).

Similarly, in the Perishable Agricultural Commodities Act ("PACA"), 7 U.S.C. § 499e(c), Congress attempted to protect the sellers of certain agricultural commodities by establishing a "trust" on the "inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products." Under the Secretary's interpretation of Section 15(a)(1), however, employee wages must be paid first, and the specific purpose of the PACA provision would be frustrated.

The inevitable conflict with Congress' explicit intention in other statutes to establish federal priority rules to assure payment of particular creditors and collection of tax revenues is one more reason for rejecting the Secretary's interpretation of the FLSA. The conflict is completely avoided by refusing to extend the FLSA beyond the area in which Congress intended it to govern: wage and hour standards.

E. The Well-Settled Construction of the FLSA Adopted in *Powell Knitting* Should Not Be Abandoned.

The Second Circuit rejected the Secretary's first attempt to extend the reach of the Fair Labor Standards Act to secured creditors. *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730 (2d Cir. 1966). In 1971, the Fourth Circuit rejected another effort by the Secretary to extend the reach of the Fair Labor Standards Act. *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971). The holding of the court of appeals in *Powell Knitting* remained settled law until this litigation.

Congress is presumed to have been aware of the Second Circuit's holding in *Powell Knitting*.[72] Congress has not modified Section 15(a)(1) to overrule *Powell Knitting*, although the Fair Labor Standards Act has been amended on at least four occasions since *Powell Knitting* was decided 20 years ago.[73] Congress' failure to amend Section 15(a)(1) is evidence that the provision was never intended to establish a secret lien or trust for wage claims, or to be used as a club for "judicial extortion" (C.A. App. 66-67) to force a secured creditor to pay its debtor's employees.

Notwithstanding the Secretary's apparent continuing misuse of Section 15(a)(1) to coerce secured creditors to pay the wages of the employees of insolvent debtors, since 1966 governing judicial authority has held that Section 15(a)(1) is not applicable to secured creditors. Before 1966 no one suggested the contrary. There is no evidence that the Secretary's administration of the FLSA has been affected in the slightest, or that the absence of

[72] *See Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2113 (1986) (plurality opinion); *Cannon* v. *University of Chicago*, 441 U.S. 677, 696-697 (1979).

[73] *See, e.g.*, Pub. L. 99-150, 99 Stat. 787 (Nov. 13, 1985); Pub. L. 95-151, 91 Stat. 1245 (Nov. 1, 1977); Pub. L. 93-259, 88 Stat. 55 (Apr. 8, 1974); Pub. L. 89-601, 80 Stat. 830 (Sept. 23, 1966).

authority to pursue secured creditors has in any way impeded accomplishment of Congress' objective. Nor does it appear that the Secretary ever sought legislation to overrule *Powell Knitting*. Instead, the Secretary filed these cases, because *Powell Knitting* "was a 1966 decision, [and] we needed to make some new law." C.A. App. 263 (testimony of Mr. J. Dean Speer, Department of Labor, Area Director).

After nearly 50 years, a settled construction of a national statute should be changed, if at all, only by Congress.[74] *Powell Knitting* was correctly decided in 1966. Even if there were some basis for concluding that the Second Circuit was wrong in *Powell Knitting*, however, judicial re-examination of the rule would be inappropriate at this late date. Whether the product of a decision of this Court or a well-reasoned decision of a lower federal court, a settled rule of law should not be reconsidered, unless it has been the source of some substantial practical difficulties.[75] Rejection of causal invitations "to make new law" is simply sound judicial administration. "[I]mitation of the past, until we have a clear reason for a change, no more needs justification than appetite. It is a form of the inevitable to be accepted until we have a clear vision of what different things we want." [76]

State law governing the priority of creditors' claims against insolvents on the one hand, and the FLSA gov-

[74] *E.g., Square D Co.* v. *Niagara Frontier Tariff Bureau Inc.*, 106 S. Ct. 1922, 1930-1931 (1986); *Herman & MacLean* v. *Huddleston*, 459 U.S. 375 (1983); *see Donovan* v. *Agnew*, 712 F.2d 1509, 1514 (1st Cir. 1983).

[75] *Cf. International Union, United Automobile, Aerospace and Agricultural Implement Workers of America* v. *Brock*, 106 S. Ct. 2523, 2533 (1986); *see also United States* v. *Maine*, 420 U.S. 515, 528 n.9 (1975) ("the doctrine of *stare decisis* carries particular force where the effect of re-examination of a prior rule would be to overturn long-accepted commercial practice").

[76] *Thomas* v. *Washington Gas Light Co.*, 448 U.S. 261, 272 n.17 (1980), quoting O. Holmes, *Collected Legal Papers* 290 (1920).

erning minimum wage and hour standards on the other have existed side-by-side for nearly 50 years. Until the Sixth Circuit's decision in this case, creditors' rights and labor standards were governed by entirely distinct bodies of law, without apparent difficulty. Neither the Secretary nor the court of appeals has offered any persuasive basis for eliminating the common sense, workable, bright line between creditors' rights and wage and hour standards that has prevailed since the FLSA was enacted in 1938.

Re-examination of the *Powell Knitting* rule would disrupt the complex scheme of interrelated state laws governing the priority of creditors' claims. As this Court correctly observed: "In structuring financial transactions, businessmen depend on state commercial law to provide the stability essential for reliable evaluation of the risks involved." *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 739 (1979). The most obvious consequences of discarding the longstanding *Powell Knitting* rule are fairly predictable. Particularly in labor-intensive industries, in which the normal outstanding payroll is a relatively larger percentage of unsecured debt, adopting the Secretary's interpretation of Section 15(a)(1) would tend to discourage secured lending and increase the costs to borrowers.[77] In addition, commercial lenders would be forced to reevaluate the adequacy of their collateral and the availability of additional funding under existing agreements, which were negotiated in reliance on the authority of *Powell Knitting*. Nonetheless, it is impossible to foresee all the ultimate consequences of interposing Section 15(a)(1) as a device for modifying the priority of creditors' claims to inventory collateral established under state law. Determination and evaluation of the

[77] *See generally* T. Jackson & A. Kronman, *Secured Financing and Priorities Among Creditors*, 88 Yale L.J. 1143, 1147-1149, 1163 (1979).

consequences of modifying established commercial practices should be left to Congress.[78]

Thus, the Sixth Circuit's re-examination of the rule firmly established in *Powell Knitting* needlessly raises issues that are best left to Congress. The competing interests of commercial lenders and employees of insolvent employers, the consequences to the commercial financing industry of changing the rule, and the extent to which (if at all) *Powell Knitting* has impeded the purpose of the FLSA, are all matters that should be determined only after "careful legislative deliberation." In short, this is a case in which it is demonstrably true that "it is more important that the applicable rule of law be settled than that it be settled right." [79]

[78] *Cf. United States* v. *Kimbell Foods, supra,* 440 U.S. 739-740 ("Because the ultimate consequences of altering settled commercial practices are so difficult to foresee, we hesitate to create new uncertainties, in the absence of careful legislative deliberation") (footnote omitted).

[79] *Square D Co.* v. *Niagara Frontier Tariff Bureau, Inc.*, 106 S. Ct. 1922, 1931 (1986), quoting *Burnet* v. *Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting); *United States* v. *Kimbell Foods, Inc., supra,* 440 U.S. 739-740.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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APPENDIX

APPENDIX

Excerpts from Hearings Before the House Committee on Education and Labor on H.R. 2033, 81st Cong., 1st Sess. 684, 688-689, 690-691 (1949):

"Mr. Higgins. Of course, the position I am in in buying from those mills is that if I buy from them, they come in and represent to me that they have complied with the wage-and-hour law. In fact, when we give them a check, we have stamped on the back that they have certified in signing the check and in endorsing that check that they have complied with the Fair Labor Standards Act of 1938. Beyond that, we cannot make a detailed investigation to tell whether or not they are actually complying.

"As I understand the present law, if we do make a mistake of buying from a mill that is actually not complying with the law, our entire inventory is subject to being frozen. We would be enjoined from shipping in interstate commerce. And, of course, in my business that would cripple me, because 90 percent of my production goes into carload shipments in interstate commerce.

* * * *

"[Rep.] Barden. [I]f he signed that check, just as you say he signed it, certifying that those logs were produced under the Wages and Hours Act, and the logs are sawed and the lumber goes into your yard, with your 1,000,000 feet of lumber on there, and it is caught and they go to the man and trace it and find him way back in the woods, and they ask, "Where did those logs go?" and he says they went to your mill, they come to you and ask, "Did you saw those logs?" You answer, "Yes, sir." They reply "O.K. Your 1,000,000 feet of lumber is hot goods." The whole 1,000,000 feet is hot goods and remains hot goods—to show you how big a mistake we can make, it remains hot goods—and there is no legal

way to extricate it from that contraband status, and you are prohibited from shipping it, selling it, or doing anything; not until the ban is lifted, but for all time.

"You cannot conceive of 435 sensible men doing that, can you? But we did not conceive of the Administrator's using that as he did. Here is how he used it: He took that clause; he would go to your man. It did not make any difference what those investigators found right, wrong, or otherwise, but assuming that they estimated—and they have a way of estimating; they do not go by the clear-cut figures. They have the authority to estimate, and we gave it to them. They go to you and say, "Listen, you either pay what we say you pay or 'bingo!' you are out of commission."

I happen to know where there was not any way for one man to appeal; there was not any way for him to argue. He got hit for approximately $20,000, and he came to my home, and he begged and begged and begged and begged. He said, "Can't I appeal? Can't I do this?"

"I said, "No: There it is."

"And three days later, he was a dead man.

"There was nothing I could do, but the Administrator says, "If you pay this we will just shut our eyes and let you go ahead and ship your lumber."

"That is not right, and that has been the practice. He exercises the right to lift the ban on the hot goods, and he has no more right to do it than you or I under this law.

"Here is the attorney [for the House Committee] sitting right here, and he is supposed to know whether I am right or wrong. If I am wrong, you are supposed to set me right.

"[The Administrator] has been exercising the privilege of using that as a club, and then saying to you, "Now, if you will go ahead and behave yourself, we will let you ship it and say nothing about it."

"Isn't that correct?

"Mr. Higgins. That is my understanding; yes, sir.

"[Rep.] Barden. And that is still written into the lawbooks right now.

"Mr. Higgins. No doubt that provision was put into the law to prevent your unscrupulous operator from just violating it wholesale.

"[Rep.] Barden. That is what we had in mind.

"Mr. Higgins. Yet, on the other hand, if I buy from 10 mills and only one of them ships a little in there and I do not know about it, then if that is uncovered later, the entire production of the 10 mills is stopped.

"[Rep.] Barden. As hot goods?

"Mr. Higgins. It is stopped at our concentration yard.

"[Rep.] Barden. And the thing that astounds me is the fact that we woke up and found that we had provided no method whatsoever for cooling off those goods. We got them hot, but we provided no cooling system for them, to where you could ever ship them again, except that the Administrator would tell you, "Well, you be a good boy and I will just wink at you. Go ahead and ship them."

* * * *

"[Rep.] Jacobs. I just want to know from the attorney; Is it the correct application of the law in the past that, if this operator purchases lumber or logs that were not produced under the standards described by the law and does so innocently, his lumber is then condemned?

"Mr. Forsythe [counsel to the House Committee]. That is right. As a general proposition, the intent and knowledge of the man who bought it does not

matter, as long as it is a violation to continue selling, once you know or it is brought to your attention that it is "hot."

"[Rep.] Barden. May I follow that with one question? There is no cooling system provided for it; is there?

"Mr. Forsythe. Not that I know of.

"[Rep.] Jacobs. I do not personally think that a man who bought it innocently should be prosecuted.

"[Rep.] Barden. We do not, either; but that is how big a mistake we can make.

"[Rep.] Jacobs. I suppose the price he paid would go to the question of intent.

"[Rep.] Barden. No; that would not have any thing to do with it, Mr. Jacobs. It would in a legal proceeding, in determining whether he was buying it in good faith. If he bought it way low, that would be strong evidence that he knew it was being produced in violation of the law.

"Mr. Higgins. That may be right, sir.

"[Rep.] Barden. And if he was to pay John Doe out here, who was running a little mill, $51, and then pay Bill Smith, who runs one over there, $50. Mr. Higgins would not get any more lumber. He might get a 2 by 4 wrapped around his neck.

"[Rep.] Jacobs. The investigator should go to the mill back in the woods and get after that fellow and make him pay up.

"[Rep.] Barden. The investigator was sent down there to get somebody. That was the philosophy of it.

"[Rep.] Jacobs. I do not say that. I am not dealing with any personalities. I am talking about the principle of the thing. The man who did wrong is the one they should get after.

"[Rep.] Barden. That is right. That is what we intended. That is what we wanted to get. But we

just made—well, a mistake; did we not, Mr. Chairman?

"[Rep.] Burke. In other words, you do not want to make the purchaser the policeman?

"[Rep.] Barden. You do not want to punish innocent people. You do not, and I do not.

"[Rep.] Jacobs. [*sic*] I think this, sir: If an investigator came to a mill or a concentration yard, such as mine, and found that that operator was buying from, say, 10 of these peckerwood mills, and he found 9 of those mills in complete accord with the act, and he found 1 fellow way off out around the Coosa River violating the law, then he should know that the concentrator is not intentionally in violation of the law. It just does not make any sense that he would have one mill set up out here which owned the small quantity that he produced and have him bringing in something that would give him the risk of having "hot goods."

"[Rep.] Barden. Your common sense would direct you. You have too much at stake. If he had the intelligence of a moron, he would not take that chance.

"Mr. Higgins. But, on the other hand, if he had an operation such as mine and found one or two mills that were more accessible which were adhering to all the provisions of the Fair Labor Standards Act, and found eight stuck out in the woods and working like the devil to violate the law, then he should have his stuff tied up.

"[Rep.] Barden. That is right. We would have reasonable grounds to assume that he was no longer an innocent man.

"Mr. Higgins. That is right. The frequency of the violation should enter into it."

(1)

No. 86-88

In the Supreme Court of the United States

OCTOBER TERM, 1986

CITICORP INDUSTRIAL CREDIT, INC., PETITIONER

v.

WILLIAM E. BROCK, SECRETARY OF LABOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Whether a secured creditor that forecloses on collateral produced under conditions violative of the minimum wage and overtime provisions of the Fair Labor Standards Act can be enjoined, as the debtor could have been, from introducing the tainted goods into interstate commerce.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 788 F.2d 1200. The opinions of the district courts (Pet. App. 18a-27a, 28a-33a) are reported at 608 F. Supp. 215 and 621 F. Supp. 22.

JURISDICTION

The judgment of the court of appeals (Pet. App. 17a) was entered on April 23, 1986. The petition for a writ of certiorari was filed on July 22, 1986, and granted on November 3, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 3(a) of the Fair Labor Standards Act, 29 U.S.C. 203(a), provides:

> As used in this Act—
>
> (a) "Person" means an individual, partnership, association, corporation, business trust, legal representative, or any organized group of persons.

Section 6 of the Fair Labor Standards Act, 29 U.S.C. 206, provides in relevant part:

> (a) Every employer shall pay to each of his employees who in any workweek is engaged in commerce or in the production of goods for commerce, or is employed in an enterprise engaged in commerce or in the production of goods for commerce, wages at the following rates:

Section 7 of the Fair Labor Standards Act, 29 U.S.C. 207, provides in relevant part:

> (a)(1) Except as otherwise provided in this section, no employer shall employ any of his employees who in any workweek is engaged in commerce or the production of goods for commerce, or is employed in an enterprise engaged in commerce or in the production of goods for commerce, for a workweek longer than forty hours unless such employee receives compensation for his employment in excess of the hours above specified at a rate not less than one and one-half times the regular rate at which he is employed.

Section 15(a)(1) of the Fair Labor Standards Act, 29 U.S.C. 215(a)(1), provides:

> (a) After the expiration of one hundred and twenty days from June 25, 1938, it shall be unlawful for any person—

> (1) to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 206 or section 207 of this title, or in violation of any regulation or order of the Administrator issued under section 214 of this title; except that no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful.

STATEMENT

1. The Fair Labor Standards Act of 1938 (FLSA or Act), 29 U.S.C. (& Supp. III) 201 *et seq.*, was designed to combat the consequences of "labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers." 29 U.S.C. 202 (a). To accomplish this, the FLSA sets out the basic

labor standards for the Nation's workforce. Section 6 requires covered employers to pay their employees a statutorily prescribed minimum wage for each hour worked. 29 U.S.C. 206. Section 7(a)(1) prohibits employers from requiring their employees to work more than 40 hours per week unless the employees are compensated at one and one half times their regular rate for each overtime hour. 29 U.S.C. 207 (a)(1). An employer who violates these provisions may be held liable for unpaid minimum and overtime wages, as well as for liquidated damages, in a suit brought either by the injured employees or by the Secretary of Labor. 29 U.S.C. 216(b) and (c). In addition, the Secretary may seek to enjoin a violation of Section 6 or 7. 29 U.S.C. 217.

The FLSA also "exclude[s] from interstate commerce goods produced * * * under conditions" that violate the Act. *United States* v. *Darby*, 312 U.S. 100, 109-110 (1941). Section 15(a)(1) of the Act makes it unlawful for "any person"—a term that is defined to include any "individual, partnership, association, corporation, business trust, legal representative, or any organized group of persons" (29 U.S.C. 203(a))—to introduce into interstate commerce "any goods" that were produced by "any employee" who was "employed in violation" of the Act's minimum wage and overtime provisions. 29 U.S.C. 215(a)(1). The Secretary may seek an injunction to enforce this prohibition under Section 17 of the Act, 29 U.S.C. 217. "Willful[]" violations of Section 15 also are criminal offenses that are punishable by fine and, in certain cases, imprisonment. 29 U.S.C. 216(a). Under the FLSA, then, only an "employer" (as separately defined in 29 U.S.C. 203(d)) may be held liable for unpaid minimum wages or overtime compensation, and only a "willful" violator may be punished criminally; but any "person" may be restrained from introducing into commerce the so-called "hot goods" that are produced under substandard labor conditions.

2. Petitioner is a corporation that makes commercial loans to industrial borrowers (Pet. App. 19a). On December 14, 1983, petitioner entered into a financing agreement with Qualitex Corporation, the corporate predecessor of a group of companies consisting of the Ely Group, Inc. (Ely Group) and its subsidiaries Rockford Textile Mills, Inc. (Rockford), and Ely & Walker, Inc. (Ely & Walker) (collectively Ely) (Pet. App. 2a; see C.A. App. 393-411). Ely did business in Tennessee, manufacturing and warehousing textiles for distribution nationwide (Pet. App. 19a).[1] Petitioner agreed to lend Ely up to $11 million by transferring funds on a daily basis to Ely's so-called "zero balance bank account" to meet Ely's daily operating expenses (*id.* at 2a & n.1).[2] The collateral securing the loan included, among other things, Ely's inventory (*id.* at 2a; C.A. App. 356-357). It is undisputed that petitioner fully perfected its security interest in the collateral (Pet. App. 2a).

[1] Rockford manufactured hosiery at a plant in McMinnville, Tennessee (Pet. App. 29a). Ely & Walker manufactured clothing in Paragould, Arkansas, and in Memphis, Tennessee, where it also operated a warehouse (*id.* at 21a).

[2] Under this arrangement, Ely was informed each day by its banks of the amount needed to cover checks that had cleared. Ely then notified petitioner of that amount. Petitioner in turn wired the necessary funds to Ely's banks. Pet. App. 2a n.1. To assure repayment, Ely's accounts receivable, when paid, were credited directly to petitioner through a "lock box" system (*id.* at 19a).

The financing agreement imposed detailed reporting requirements on Ely (see Pet. App. 2a). Among other things, Ely was obligated to provide petitioner with a weekly schedule of inventory (C.A. App. 366) and a monthly balance sheet, statement of accounts receivable and sales, and income statement (*id.* at 367). Ely also was subject to a number of other reporting requirements relating to its customers (*id.* at 359), machinery (*id.* at 360), accounts receivable (*id.* at 369), and financial condition (*ibid.*). It was required to provide petitioner with essentially all financial information that petitioner might request (*id.* at 367). And Ely was obligated to provide petitioner with access to all of its records, files, and books of account (*id.* at 366). During the term of the agreement, petitioner sent its representatives to Ely's premises to monitor Ely's inventory, sales, credits, and purchases (Pet. App. 20a). Although petitioner did not verify that Ely was paying its employees, the district court found that petitioner checked payroll records to determine whether Ely paid employee taxes (*ibid.*).

3. Ely's sales started falling below projections in the fall of 1984, and Ely stopped reporting to petitioner in January 1985 (Pet. App. 2a-3a). By early February 1985, Ely's loan balance had increased to approximately $9,500,000, and Ely had defaulted on certain obligations under the financing agreement. Petitioner last advanced funds to Ely on February 8, 1985. *Id.* at 3a. On February 11, 1985, petitioner terminated the financing agreement and demanded payment in full of Ely's obligations (*ibid.;* see *id.* at 20a).

At the time that petitioner cancelled the agreement, it was aware that it had been funding Ely's

payroll and that "when this funding ceased Ely could not meet its payroll obligations to its employees" (Pet. App. 19a). Petitioner nevertheless did not foreclose immediately after terminating the agreement, instead giving Ely an opportunity to devise a plan for continuing its operations (*id.* at 20a; see Pet. Br. 5). Ely's employees, meanwhile, many of whom were working on rush orders of seasonal clothing for three large retail chains (see C.A. App. 274-280), were not informed of these developments. They continued working until February 19, 1985, when petitioner finally did foreclose and take possession of the collateral and Ely ceased operations (Pet. App. 3a). Petitioner's representatives had remained on Ely's premises through that date, monitoring Ely's activities (C.A. App. 191, 192, 214, 215, 230, 277, 278).

Following the plant closings, the Wage and Hour Division of the Department of Labor began an investigation to determine whether Ely's employees had been paid in accordance with the FLSA. The investigation revealed that Ely had failed to pay its employees for various periods between January 27, 1985, and February 19, 1985 (Pet. App. 3a). The Department of Labor therefore concluded that the items manufactured during those periods were hot goods that had been produced in violation of Sections 6 and 7 of the FLSA and that, under Section 15(a)(1), could not be introduced into interstate commerce.

The Department of Labor investigators also learned that petitioner had stated its intention to sell Ely's collateral (Pet. App. 22a; see *id.* at 3a) and that petitioner had already shipped a portion of Ely's goods interstate with knowledge that the Ely employees had not been paid (*id.* at 21a). On March 15,

1985, and March 21, 1985, the Secretary accordingly brought separate but related actions against Ely and petitioner in the United States District Court for the Eastern and Western Districts of Tennessee. The Secretary alleged actual and potential violations of Section 15(a)(1) of the FLSA, and sought to enjoin both Ely and petitioner from placing in interstate commerce goods that had been produced from February 3 through February 19, 1985 (Pet. App. 3a-4a).[3]

4. Both district courts subsequently entered preliminary injunctions against the shipment of Ely's inventory (Pet. App. 18a-27a, 28a-33a). They held that Section 15(a)(1)—which makes it unlawful for "any person" to ship hot goods interstate—prohibited not only Ely but also petitioner from transporting or selling items produced by employees who had not been paid. The courts noted that Section 15(a)(1) makes no exception for creditors who acquire hot goods through foreclosure, and the courts "refuse[d] to read such an exception into the Act." Pet. App. 32a; see *id.* at 25a.

Both courts reasoned that this straightforward reading of Section 15(a)(1) drew support from the statutory policy of " 'exclud[ing] from interstate commerce' goods produced under substandard labor conditions" (Pet. App. 24a (quoting *Darby*, 312 U.S. at 109-110); see Pet. App. 31a). As the Western District court noted," [t]his 'evil' is the same whether the goods are sold and shipped in commerce by the manufacturer or by a foreclosing creditor" (*id.* at 24a); "[m]oreover, if foreclosing creditors are free to ship and sell tainted goods across state lines, the

[3] The Secretary also sought back pay and liquidated damages from Ely under Sections 16(c) and 17 of the FLSA.

temptation to overextend credit to marginal producers is strong, as is the likelihood that such producers will become unable to meet their payrolls" (*ibid.*).[4]

The district courts therefore concluded that "[s]ecured creditors such as [petitioner] take their security subject to the laws of the land. If such creditors have a security interest in property which was produced in violation of the provisions of the Fair Labor Standards Act, they retain their security interest"—but that interest "is subject to the provisions of the Act." Pet. App. 32a; *id.* at 25a. The courts added that while the most culpable party here is Ely, "in light of the purposes of the Act, it would be an unjust and harsh result for the creditor to get the benefit of the labor of the employees during the period of time they produced goods and were not paid as provided by the Act; a benefit which the creditor would not have without the employees['] labor" (*id.* at 32a-33a; *id.* at 26a).

[4] The court in the Western District expressly found that, while there was no evidence of collusion between petitioner and Ely, "the evidence does show that [petitioner] knew it was funding the payroll of Ely Group, Inc., and when this funding ceased Ely could not meet its payroll obligations to its employees" (Pet. App. 19a). In addition, the court found that petitioner had shipped goods in interstate commerce after Ely ceased operations "and did so with knowledge that employees of the various entities had not been paid" (*id.* at 21a). The court also noted that petitioner had negotiated a possible sale of a major part of Ely's assets and planned an imminent transfer of inventory from Ely & Walker's Memphis warehouse to Nashville, Tennessee (*ibid.*). The Eastern District court expressly reserved the question whether there had been collusion between petitioner and Ely because it concluded that petitioner should be enjoined from shipping Ely's goods in any event (*id.* at 31a).

A divided panel of the court of appeals affirmed (Pet. App. 1a-16).[5] The court "follow[ed] the 'plain language' of the statute" in "conclud[ing] that the phrase 'any person' applies to [petitioner], as a secured creditor" (*id.* at 7a (footnote omitted)). In reaching this conclusion, the court emphasized that "one of the reasons that Congress passed the FLSA was to exclude tainted goods from interstate commerce" and that "prohibiting secured creditors, such as [petitioner], from shipping 'hot goods' in interterstate commerce furthers that Congressional intent" (*ibid.*). This result, the court reasoned, "does not change the priorities in bankruptcy. [Petitioner] 'owns' the goods. The 'hot goods' provision merely prevents [petitioner] from shipping, delivering or selling the goods in interstate commerce" (*id.* at 10a).

The court accordingly rejected the reasoning of *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730 (2d

[5] On April 10, 1985, the United States District Court for the Eastern District of Tennessee granted petitioner's motion for a stay of the preliminary injunction pending appeal. The stay permitted the delivery and sale of inventory worth about $200,000, on the condition that petitioner place the proceeds of the sale in a separate interest-bearing account to be used to pay the wages of Ely's former employees at Rockford in the event that Section 15(a)(1) ultimately was held to apply to petitioner (C.A. App. 104-105). The district court in the Western District of Tennessee denied a similar motion, but the court of appeals granted a stay on the same condition on March 29, 1985 (Pet. App. 4a), permitting petitioner to sell Ely and Walker's assets as an ongoing business. The court of appeals subsequently modified the stay to permit petitioner, which had paid more than $4.5 million into an interest-bearing escrow account, to withdraw all but $1.5 million (*id.* at 34a-35a).

Cir. 1966), which had held that Section 15(a)(1) is inapplicable to secured creditors who take possession of goods produced in violation of the FLSA. The court of appeals found the creation of such a judicial exception to the reach of Section 15(a)(1) inappropriate. Pet. App. 9a. The court also reasoned that such an exception would be inconsistent with the congressional intention that hot goods not "taint the channels of interstate commerce" or "compete with goods produced in conformity with the FLSA's minimum wage and overtime provisions," and thus would conflict with the interpretation of the FLSA set out in *United States* v. *Darby*, *supra* (Pet. App. 10a). And the court of appeals, noting that Congress had created an explicit but limited exception to Section 15(a)((1) for certain good faith purchasers of hot goods—an exception for which petitioner did not qualify—concluded that petitioner "should not be in a better position as a secured creditor, for which Congress has not created an exception[,] than as a 'good faith purchaser,' for which Congress specifically added an exception" (Pet. App. 12a).[6]

[6] Judge Engel dissented (Pet. App. 13a-16a). He stated that "[i]f we were writing upon a clean slate, the majority opinion, in adopting a literal interpretation of the Fair Labor Standards Act, would have considerable appeal for the term 'any person' is indeed broad and has been carefully defined by Congress" (*id.* at 13a). In his view, however, under a "common sense application of section 15(a)(1), Congress was looking instead at application of the Act in the course of the ongoing production of goods and not at the situation obtaining here" (*id.* at 15a). He therefore would have followed the holding of *Powell Knitting Mills* (see *id.* at 15a-16a).

SUMMARY OF ARGUMENT

As petitioner acknowledged below—and as the plain terms of the Fair Labor Standards Act make clear—Ely's failure to pay its employees violated the Act. Ely therefore was prohibited by Section 15(a)(1) from placing the goods produced by its employees' unpaid labor into interstate commerce. The question in this case is whether petitioner, a creditor that acquired the "hot goods" from Ely by foreclosure, is also bound by this federal statutory restriction. The text, legislative history, and purposes of the "hot goods" clause all compel an affirmative answer.

1. The text is dispositive. Section 15(a)(1) prohibits "any person" from "transport[ing] * * * or sell[ing] in commerce * * * any goods in the production of which any employee was employed in violation of [the FLSA's minimum wage and overtime provisions]." The breadth of that prohibition is confirmed by two explicit exemptions to Section 15(a)(1), neither of which is applicable here: one for common carriers, and a limited exemption (for which petitioner does not qualify) added in 1949 for good faith purchasers who obtain goods on "written assurance from the producer that the goods were produced in compliance with [the FLSA]." That Congress felt the need to write these exemptions into the Act plainly demonstrates its expectation that the bar on the transportation of hot goods would otherwise be all-inclusive. And given these precisely drawn exemptions, petitioner cannot plausibly suggest that an additional exception should be implied for the benefit of secured creditors.

The legislative history adds two compelling points. First, Congress let it be known that it had drafted

the FLSA with special care and intended its words to be applied as written; this Court has, accordingly, always construed the Act literally and liberally " 'to apply to the furthest reaches consistent with congressional direction.' " *Tony & Susan Alamo Foundation* v. *Secretary of Labor*, 471 U.S. 290, 296 (1985) (citation omitted). Second, Congress in 1938 specifically considered—and declined to enact—a provision that would have exempted certain "nonculpable" persons from the prohibitions of Section 15(a)(1). A limited form of such an exemption was added 11 years later, in which Congress for the first time "*ma[de] it lawful* for a purchaser in good faith of goods produced in violation of the act to sell such goods in commerce" (H.R. Conf. Rep. 1453, 81st Cong., 1st Sess. 31 (1949) (emphasis added)), if the purchaser had "written assurance" from the manufacturer of the latter's compliance with the statutory standards. If Congress had wanted to create a broader exemption for *all* good faith purchasers, or for secured creditors, it surely knew how to do so.

2. "[T]he goal [of the FLSA] is to outlaw[] from interstate commerce goods produced under conditions that fall below minimum standards of decency" (*Tony & Susan Alamo Foundation*, 471 U.S. at 296). This goal is well served by reading the statute literally and applying it to, among others, creditors in the position of petitioner. Doing so puts both struggling employers like Ely and the creditors that oversee their operations on notice that failure to pay employees is not an acceptable (or profitable) means of cutting costs. It also eliminates the incentive that creditors would otherwise have to encourage the continuation of manufacturing operations—and the production of collateral—under conditions where employees will likely not be paid.

3. Although petitioner asserts repeatedly that the decision below creates a "secret lien" on behalf of Ely's employees and somehow disturbs "creditors' rights," the court of appeals' ruling in fact does nothing of the kind. It does not give the employees any lien, secret or otherwise, or any other rights in the hot goods. It does not alter petitioner's rights in the goods as against its debtor, Ely, or as against Ely's other creditors. It merely enforces a statute that, for reasons grounded in public policy, prohibits the shipment of hot goods by anyone. Such a generally applicable restriction on a particular use of particular goods does not affect "creditors' rights" merely because a creditor chooses such goods as collateral. Indeed, the FLSA is simply one of many statutes, such as the Flammable Fabrics Act (15 U.S.C. 1191 *et seq.*), that prohibit for public policy reasons the interstate shipment of specified goods; such statutes obviously do not create liens or affect the rights of creditors as such.

The fact that the taint affecting the hot goods is one that can be cured by the payment of wages to Ely's employees does not change the analysis. The suit here was brought by the Secretary not to collect a debt but to redress an injury to the public. In analogous circumstances, a creditor foreclosing on, for example, flammable fabrics, which may not be introduced into interstate commerce, might elect to treat the fabrics to bring them into conformity with the statutory standard. Such an arrangement obviously would not create a lien or have anything to do with creditors' rights. This case differs only in that a different federal policy is involved.

ARGUMENT

A SECURED CREDITOR THAT FORECLOSES ON COLLATERAL PRODUCED UNDER CONDITIONS VIOLATIVE OF THE FAIR LABOR STANDARDS ACT CANNOT TRANSPORT THAT COLLATERAL IN INTERSTATE COMMERCE

The Fair Labor Standards Act is a broad and straightforward statute. It mandates the payment both of a minimum wage and of overtime compensation to covered employees, and its plain terms flatly exclude from interstate commerce the "hot goods" that are produced by workers who have not been paid in conformity with the statutory standard. In this case, it is undisputed that Ely's employees did not receive wages for the relevant period; it is also conceded that petitioner wished to introduce into interstate commerce the goods produced by those employees. Petitioner's brief therefore necessarily reduces to a lengthy argument that the FLSA does not mean what it says. Not surprisingly, petitioner's analysis "would restrict the Act not only arbitrarily but also inconsistently with its broad purposes." *Powell* v. *United States Cartridge Co.*, 339 U.S. 497, 515 (1950).

A. Ely's Failure To Pay Its Employees Violated The Fair Labor Standards Act

A threshold question in this case is whether the Ely inventory on which petitioner foreclosed constituted "hot goods"—whether, that is, the inventory had been produced under conditions that violated the Act. Petitioner obliquely suggests in this Court that Ely's failure to pay its employees did not violate the Act because Sections 6 and 7 of the FLSA "address wage rates rather than the problem of nonpayment due to insolvency" (Pet. Br. 16; see *id.* at 22).

Below, however, petitioner acknowledged that Ely's failure to pay its employees violated the Act,[7] and the court of appeals found it obvious that "the goods that Ely produced during [the period when its employees received no wages] were produced in violation of the FLSA's minimum wage and overtime provisions" (Pet. App. 3a (footnote omitted)).

Whatever petitioner's current position on the question, the court of appeals' conclusion plainly was correct. Section 6(a) of the FLSA provides flatly that "[e]very employer *shall pay* [the statutory minimum wage] to each of his employees" (29 U.S.C. 206(a) (emphasis added)), while Section 7(a)(1) states that "no employer shall employ any of his employees" in excess of 40 hours per week "unless such employee *receives compensation*" at one and one-half times his regular rate (29 U.S.C. 207(a)(1) (emphasis added)). The Act makes no exception for employers who are unable to pay, or who are unwilling for any other reason to comply with the statutory requirements. To the contrary, it has been understood for over 40 years that "[t]he Act does not exempt employers who are in financial difficulties." *Torres* v. *American R. Co.*, 157 F.2d 255, 256 (1st Cir.), cert. denied, 329 U.S. 782 (1946). See *Hodgson* v. *A-1 Ambulance Service, Inc.*, 455 F.2d 372, 373-375 (8th Cir. 1972) (employer's financial difficulties do not relieve it of the obligation to pay wrongfully withheld minimum wages and overtime pay); *Hodgson* v. *Taylor*, 439 F.2d 288, 290 (8th Cir. 1971) (same); *Wirtz* v. *Malthor, Inc.*, 391 F.2d 1, 3 (9th Cir. 1968)

[7] Petitioner argued instead that "Ely's violation of the FLSA does not subject [petitioner] to being enjoined under that Act" (Pet. C.A. Br. 10).

(same); *Torres*, 157 F.2d at 256 (same).[8] Indeed, a contrary interpretation would induce employers to gamble (as Ely did here), obtaining labor they are not likely to be able to pay for.

Petitioner's suggestion (Pet. Br. 16-17) that an employer complies with the Act so long as its posted or promised wage rates exceed the statutory minima —even if its employees are not actually compensated at those rates—thus is insupportable. Such an employer obviously has not "pa[id] [the minimum wage] to each of his employees" as required by Section 6, and the employees in turn have not "receive[d] [overtime] compensation" as mandated by Section 7. And allowing an employer to escape the Act simply by posting wage rates that it later fails to pay (or, as in Ely's case, that it lacks the means to pay) would, of course, render the FLSA's protections largely nugatory.[9]

[8] Indeed, even the two cases upon which petitioner relies (Pet. Br. 46-49) for the proposition that secured creditors are outside the scope of the FLSA (*Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730, 733 (2d Cir. 1966), and *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487, at 44,732 (4th Cir. 1971), took it for granted that an employer violates the FLSA when insolvency prevents it from paying its employees. See also *Dunlop* v. *Sportsmaster, Inc.*, 77 Lab. Cas. (CCH) ¶ 33,293, at 47,136 (E.D. Tenn. 1975) (when employees were not paid by an insolvent employer, "it is clear that all [goods] manufactured during that [period] were produced in violation of the Act").

[9] Petitioner is incorrect in contending (Pet. Br. 17) that the FLSA "add[s] nothing" to "[t]he employer's obligation under state law to pay the full amount of wages due." At the simplest level, the FLSA provides remedies that supplement those available under state law, such as liquidated damages and attorneys' fees. 29 U.S.C. 216(b). More importantly, the Secretary may bring an FLSA action, either for damages

B. Section 15(a)(1) Bars The Interstate Shipment of Hot Goods Acquired by Secured Creditors Through Foreclosure

1. *The Statutory Language.* a. The conclusion that the goods acquired by petitioner were produced in violation of the Act is dispositive here. Section 15 (a)(1) prohibits "*any person*" from "transport[ing] * * * or sell[ing] in commerce * * * any goods in the production of which any employee was employed in violation of [the FLSA's minimum wage and overtime provisions]." 29 U.S.C. 215(a)(1) (emphasis added). Section 3(a) of the FLSA in turn expansively defines "person" to include "an individual, partnership, association, corporation, business trust, legal representative, or any organized group of persons." 29 U.S.C. 203(a). Corporate entities like petitioner thus fall squarely within the language of Section 15(a)(1)—as both the dissenting judge below (see Pet. App. 13a) and the Second Circuit in

(see 29 U.S.C. 216(c)) or for injunctive relief (including injunctive relief against the withholding of minimum wages or overtime compensation "found by the court to be due") (29 U.S.C. 217). Such an action, while it may benefit the affected employees, is designed to serve the public interest (see pages 39-41, *infra*) and may be brought even over the objection of the employees involved. Indeed, the ability of the Secretary to bring an action is essential to preserve the efficacy of the Act, given the possibility that employers may coerce employees to surrender their FLSA rights—a prospect that was of considerable concern to the drafters of the FLSA. See *Brooklyn Savings Bank* v. *O'Neil*, 324 U.S. 697, 707-708 (1945). It is true, of course, that an employer's insolvency might make futile an attempt to enjoin further FLSA violations or to collect back pay. See generally *Donovan* v. *Brown Equipment & Service Tools, Inc.*, 666 F.2d 148, 159 (5th Cir. 1982); *Taylor*, 439 F.2d at 290. But that unhappy circumstance does not alter the fact of the employer's violation.

Wirtz v. *Powell Knitting Mills Co.*, 360 F.2d 730, 732 (1966), acknowledged.

The statutory structure confirms that Congress acted deliberately in making Section 15(a)(1) broadly applicable to "any person." That provision contains two explicit exceptions to the otherwise general bar on the interstate shipment of hot goods. The first, which was enacted with the original FLSA in 1938, exempts common carriers from the statutory restriction on the transportation of such goods—an exemption that would hardly have been necessary if, as petitioner suggests, the prohibition was meant to apply only to those responsible for the violation. The second exception, added in 1949, exempts purchasers of goods if, but only if, they can show that they "acquired [the hot goods] in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of [the FLSA], and [that they] acquired such goods for value without notice of any such violation." See 29 C.F.R. 789.5.[10]

Given these narrow and precisely drawn exceptions for certain persons far removed from the FLSA violation, petitioner cannot plausibly suggest either that

[10] The means by which ultimate consumers are excluded also confirms the breadth of Section 15(a)(1). The provision prohibits the shipment of "goods" produced in violation of the Act, and the FLSA defines the term "goods" to exclude "goods after their delivery into the actual physical possession of the ultimate consumer thereof other than a producer, manufacturer or processor thereof." 29 U.S.C. 203(i). See *United States Cartridge Co.*, 339 U.S. at 513. Until the "products have been delivered into the actual physical possession of their ultimate consumer," however, they remain subject to the reach of Section 15(a)(1) (*United States Cartridge Co.*, 339 U.S. at 513).

the prohibition is not a broad one or that an additional exemption from Section 15(a)(1) should be implied for the benefit of secured creditors. See *Mabee* v. *White Plains Publishing Co.*, 327 U.S. 178, 183-184 (1946); *Addison* v. *Holly Hill Fruit Products Co.*, 322 U.S. 607, 617 (1944). See generally *Andrus* v. *Glover Construction Co.*, 446 U.S. 608, 616-617 (1980). As the court of appeals observed, petitioner "should not be in a better position as a secured creditor, for which Congress has not created an exception[,] than as a 'good faith purchaser,' for which Congress specifically added an exception" (Pet. App. 12a).[11]

Other features of the FLSA also belie petitioner's attempt to read unstated limitations into the statutory language. The centerpiece of petitioner's analysis of the Act is its assertion that Section 15(a)(1) may be applied only against entities involved in "the chain of production and distribution of goods in interstate commerce," and to "culpable parties" (Pet. Br. 26). In fact, Congress specifically limited the reach of *other* provisions of the FLSA to such entities. The prohibitions against the use of child labor set forth in Section 12(a) of the Act, for example, are enforceable only against "producer[s], manufacturer[s] and dealer[s]." 29 U.S.C. 212(a); see also 29 U.S.C. 215(a)(4). Culpability is expressly addressed in Section 16(a), which provides criminal penalties for "willful[]" violators of Section 15. 29 U.S.C. 216(a). Cf. *Brooklyn Savings Bank* v. *O'Neil*, 324 U.S. 697, 709 (1945). Back pay may be sought only from offending "employer[s]" (see 29 U.S.C. 216(b))—a term that Congress defined separately, and far less broadly, than the term "person." Compare 29 U.S.C. 203(a) with 29 U.S.C. 203(d). Yet Congress pointedly omitted any of these limitations from Section 15(a)(1), which is applicable to "any person." The obvious conclusion to draw from these contrasts within the Act is that Congress specifically intended Section 15(a)(1) to apply broadly, as its language suggests. See generally *INS* v. *Cardoza-Fonseca*, No. 85-782 (Mar. 9, 1987), slip op. 10; *id.* at 1-2 (Scalia, J., concurring in the judgment). Cf. *United States Cartridge Co.*, 339 U.S. at 517.

b. A literal reading of the broad language of Section 15(a)(1) accords with this Court's usual approach to the FLSA. Noting the care with which the statute was written, the Court has explained that it is inappropriate to "draw on some unexpressed spirit outside the bounds of the normal meaning of words" when reading the Act. *Holly Hill*, 322 U.S. at 616-617. Instead, the Court "has consistently construed the Act 'liberally to apply to the furthest reaches consistent with congressional direction' "

[11] Although petitioner obliquely suggests otherwise (Pet. Br. 37 n.56), it plainly cannot benefit from Section 15(a)(1)'s existing bona fide purchaser exemption. Petitioner did not acquire the collateral "without notice" of Ely's FLSA violation, as the statutory exemption requires; to the contrary, petitioner was aware of Ely's failure to pay its employees prior to the acquisition (see C.A. App. 305-306) and shipment (see Pet. App. 21a) of the collateral, and petitioner knew more generally that it had been funding Ely's payroll (*id.* at 19a). In addition, as the court of appeals observed, even if a secured creditor can be said to "purchase" goods when it forecloses on them, petitioner "does not qualify as a 'good faith purchaser' because [it] did not rely 'on written assurance from the producer that the goods were produced in compliance with the requirements of [the FLSA]' " (*id.* at 11a-12a; see *id.* at 12a n.11). Presumably for these reasons, petitioner did not contend below that it qualified as a good faith purchaser (see *id.* at 11a).

(*Tony & Susan Alamo Foundation* v. *Secretary of Labor*, 471 U.S. 290, 296 (1985) (quoting *Mitchell* v. *Lublin, McGaughy & Associates*, 358 U.S. 207, 211 (1959)). In doing so, the Court has explained that exemptions from the FLSA's requirements are appropriate only if "plainly and unmistakably within [the Act's] terms and spirit" (*A. H. Phillips, Inc.* v. *Walling*, 324 U.S. 490, 493 (1945)), and should not be "enlarge[d] by implication" (*Holly Hill*, 322 U.S. at 618). The Court has repeatedly applied this principle in refusing to read unstated exceptions either into Section 15(a)(1) (see *White Plains Publishing Co.*, 327 U.S. at 181, 183-184) or into the definitional provisions of Section 3 (see *United States Cartridge Co.*, 339 U.S. at 512-515; *United States* v. *Rosenwasser*, 323 U.S. 360, 362-363 (1945); see generally *Tony and Susan Alamo Foundation*, 471 U.S. at 295).[12]

The Secretary of Labor, whose interpretation of the FLSA is entitled to substantial deference (see, *e.g. Tony and Susan Alamo Foundation*, 471 U.S. at 297), has also consistently read Section 15(a)(1) broadly and literally. The Secretary has brought successful actions under the provision against a range of persons who, like petitioner, were at least one step removed from the employer that committed the minimum wage or overtime violation. See, *e.g.*, *Southern Advance Bag & Paper Co.* v. *United States*, 133 F.2d

[12] Similarly, the Court has declined to give a broad reading to Section 13, 29 U.S.C. 213, which creates exemptions from the FLSA's coverage, explaining that "[i]t is well settled that exemptions from the Fair Labor Standards Act are to be narrowly construed." *Mitchell* v. *Kentucky Finance Co.*, 359 U.S. 290, 295 (1959). See *Arnold* v. *Ben Kanowsky, Inc.*, 361 U.S. 388, 392 (1960).

449 (5th Cir. 1943) (manufacturer covered where producer of component materials violated the Act); *Wirtz* v. *Lone Star Steel Co.*, 405 F.2d 668, 670 (5th Cir. 1968) (mill owner covered where violation committed by independent contractor). And the Secretary has sought to apply Section 15(a)(1) against secured creditors for more than 20 years.[13]

2. *Legislative History.* a. While the clarity of the statutory language is enough to resolve this case, the legislative history of the FLSA also provides compelling support for the court of appeals' conclusion that Congress meant what it said in applying Section 15(a)(1) to "any person." The FLSA was enacted shortly after this Court's invalidation of a congressional delegation of power in *A.L.A. Schechter Poultry Corp.* v. *United States*, 295 U.S. 495 (1935). To forestall another delegation challenge, the FLSA was drafted with precision. As the Senate Committee on Education and Labor explained, "[t]he committee has diligently endeavored to write in the law itself, the rules and legal prohibitions intended to accomplish the desired objectives * * * [t]he committee[] seeking thus to decide every question that calls for a decision by Congress on legislative policies." S. Rep.

[13] The Secretary's attempts to enjoin creditors from shipping hot goods were unsuccessful in *Powell Knitting Mills, Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971), and *Dunlop* v. *Sportsmaster, Inc.*, 77 Lab. Cas. (CCH) ¶ 33,293 (E.D. Tenn. 1975). The Secretary prevailed against a secured creditor in *Brock* v. *LTW Sportswear, Inc.*, C.A. No. 2-86-007 (M.D. Tenn. Aug. 22 and 29, and Sept. 18, 1986), and against a similarly situated entity in *Brock* v. *Kentucky Ridge Mining Co.*, C.A. No. 85-0180-O(M) (W.D. Ky. Oct. 11, 1985), as well as in the district courts and court of appeals below.

884, 75th Cong., 1st Sess. 5 (1937).[14] See generally *Fair Labor Standards Act of 1937: Joint Hearings on S. 2475 and H.R. 7200 Before the Senate Comm. on Education and Labor and the House Comm. on Labor*, 75th Cong., 1st Sess. 1-89 (1937) (statement of Ass't Att'y Gen. Robert H. Jackson) (*1937 Joint Hearings*). Given the pains taken with the statutory language, it is hardly likely that Congress expected either the courts or the Secretary to discover unwritten exemptions in the Act.[15]

[14] S. 2475, 75th Cong., 1st Sess. (1937), the bill ultimately enacted as the FLSA, initially provided for the creation of a Labor Standards Board to administer the Act. This Board was to have broad authority, among other things, to set minimum wages and maximum hours, and to grant exemptions from various standards set by the Act (see S. 2475, *supra*, §§ 4, 6, 18). In the interest of legislative precision, however, Congress chose not to create the Board, opting instead to write nationwide wage and hour standards into the Act itself. Congress also chose to delegate more limited administrative authority to an extant agency, the Department of Labor. See H.R. Rep. 2182, 75th Cong., 3d Sess. 2-3, 6, 9 (1938); H.R. Conf. Rep. 2738, 75th Cong., 3d Sess. 29-30 (1938). See generally *Gemsco, Inc.* v. *Walling*, 324 U.S. 244, 263-264 (1945). At the same time, Congress rejected a number of exemptions that appeared in the initial bill, and consolidated and made more specific those that were retained. Compare S. 2475, *supra*, with 52 Stat. 1070. See generally H.R. Conf. Rep. 2738, *supra*, at 29.

[15] In arguing that Congress did not intend the hot goods clause to be broadly applicable, petitioner relies exclusively on snippets from the hearings that preceded enactment of the FLSA (see Pet. Br. 27-28 & n.36). Petitioner cites these excerpts for the proposition that Congress made Section 15(a)(1) applicable against "any person" simply to ensure that a principal could be enjoined from shipping hot goods that had been produced by a subcontractor under substandard conditions. The cited excerpts do indeed indicate that the drafters of the Administration's bill intended Section 15(a)(1) to apply in such a situation. See *1937 Joint Hearings* 74-75, 86-87 (statement of Ass't Att'y Gen. Robert H. Jackson). But there is absolutely no hint in the hearings that those drafters—let alone Congress—intended Section 15(a)(1) to apply *only* in that situation. To the contrary, several witnesses understood that the proposed legislation would prevent even "innocent purchasers without notice" from "shipping [hot goods] in interstate commerce." *1937 Joint Hearings* 937 (statement of George H. Davis, President, Chamber of Commerce of the United States); *id.* at 941 (statement of Rep. Thomas). The congressional reports themselves provide no indication that Section 15(a)(1) contains hidden exceptions; the reports describe the statute as broadly "mak[ing] it unlawful to ship or sell in commerce * * * any goods in the production of which any employee was employed in violation of section 6 or 7." H.R. Conf. Rep. 2738, *supra*, at 33. See H.R. Rep. 2182, *supra*, at 14; S. Rep. 884, *supra*, at 7.

The care paid to the language of the FLSA is particularly significant here, because Congress devoted considerable attention to the specific question whether "innocent" purchasers of hot goods should be exempted from Section 15(a)(1). As noted above, Section 15(a)(1) originally contained one exception, for common carriers. That Congress felt the need to write such an exception into the Act plainly reflected its expectation that the bar on the transportation of hot goods would otherwise be all-inclusive. Indeed, the common carrier exception was drafted not because Congress wanted generally to permit the shipment of hot goods by "nonculpable" parties, but rather "to prevent a case involving the constitutionality of the act from arising in a suit between a shipper and a common carrier, to which the Government was not a party, inasmuch as the common carrier has no interest in the issue of constitutionality, but only in its

obligation to accept goods for transportation." H.R. Rep. 2182, 75th Cong., 3d Sess. 14 (1938).

At the same time, Congress carefully considered—and declined to enact—a provision that would have permitted certain good faith purchasers to escape the ban on the shipment of hot goods. That provision, contained in a bill that passed the Senate (and that, as significantly modified, became the FLSA), would have permitted a proposed Labor Standards Board to exempt goods from the reach of Section 15(a)(1) if, among other things, the Board found that the persons with an interest in the goods "had no reason to believe that any substandard labor condition existed in the production of such goods." S. 2475, 75th Cong., 1st Sess. § 18(c) (1937). See S. Rep. 884, *supra*, at 9. This provision, however, did not survive consideration by the House Labor Committee (compare H.R. Rep. 1452, 75th Cong., 1st Sess. 19 (1937), with H.R. Rep. 2182, *supra*, at 15), and did not appear in the final bill that emerged from conference. See H.R. Conf. Rep. 2738, 75th Cong., 3d Sess. 25-26, 33 (1938). Congress thus deliberately declined to carve out an exception to Section 15(a)(1) for persons who are not directly responsible for the violation of the Act.[16]

[16] Congress also considered, but declined to enact, a provision that would have excepted certain persons from criminal prosecution for transporting hot goods. Both the full Senate and the House Labor Committee initially approved a provision that would have barred prosecution of any person—other than the producer—who had secured a written representation from the producer that the shipped goods had been produced in compliance with the Act. See S. 2475, *supra*, § 14c; H.R. Rep. 1452, *supra*, at 18. Again, however, this provision did not appear in the bill that ultimately passed the House, and did not survive conference. See H.R. Conf. Rep. 2738, *supra*, at 20, 26, 33.

Petitioner takes a different view of the significance of this legislative history. Noting that Congress did not specifically explain its reasons for dropping the proposed good faith exception (see Pet. Br. 30-31), petitioner suggests that "the only plausible inference that can be drawn from the omission of the [Labor Standards Board's] exemption authority is that Congress reasonably concluded that the provision was unnecessary" (*id.* at 32). This argument—which amounts to an assertion that Congress should be deemed to have enacted an exemption that it specifically removed from the legislation—has no merit whatsoever.

First, petitioner's suggestion that Congress viewed a good faith exception as "unnecessary" is belied by the enactment of the exception for common carriers, which evidences the congressional expectation that all entities are to be covered by Section 15(a)(1) unless specifically exempted. More fundamentally, petitioner's argument turns on its head the Court's usual approach to statutory interpretation. "'Few principles of statutory construction are more compelling than the proposition that Congress does not intend *sub silentio* to enact statutory language that it has earlier discarded in favor of other language.'" *Cardoza-Fonseca*, slip op. 21 (citation omitted). See generally *Fox* v. *Standard Oil Co.*, 294 U.S. 87, 96 (1935). And even if Congress's decision to delete the proposed good faith exception is not itself probative of a specific congressional intent to *subject* good faith purchasers to the prohibitions of Section 15(a)(1),[17]

[17] Noting that the good faith exception would have been administered by the proposed Labor Standards Board, petitioner suggests (Pet. Br. 30-31) that omission of the exception from the Act was an essentially inadvertent consequence of

the consideration and subsequent deletion of the exception can hardly be said to *exempt* such entities from the prohibition against the shipment of hot goods. As this Court has noted in rejecting a similarly farfetched argument from the FLSA's legislative history, "[t]he plain words and meaning of a statute cannot be overcome by a legislative history which, through strained processes of deduction from events of wholly ambiguous significance, may furnish dubious bases for inference in every direction." *Gemsco, Inc.* v. *Walling*, 324 U.S. 244, 260 (1945).

b. Similar observations may be made about petitioner's reliance (Pet. Br. 32-38) on the 1949 amendment of Section 15(a)(1), which permits the shipment of hot goods by a purchaser who acquired the goods for value, in good faith, without notice of the FLSA violations, and after obtaining written assurance from the producer that the goods had been manufactured in compliance with the Act. Relying on snippets from congressional hearings, petitioner maintains that the 1949 amendment "confirmed what

Congress's decision not to create such a Board. See note 14, *supra*. The deleted provision, however, simply gave the Board the authority to except certain goods from the reach of Section 15(a)(1) if it was "established to the satisfaction of the Board that every person having a substantial proprietary interest in the goods had no reason to believe that any substandard condition existed in the production of the goods." S. Rep. 884, *supra*, at 9. The exemption thus would have permitted the Board to lift, through administrative action, the otherwise generally applicable bar to the shipment of hot goods. By failing to create an agency that could grant such administrative relief, Congress kept the bar absolute. It is appropriate to add that, had the FLSA as enacted contained the deleted provision, petitioner—which became aware of Ely's failure to pay its employees prior to foreclosure—would not have qualified for an exemption on the facts of this case.

was manifestly implicit in the Act, as adopted in 1938, namely, that Section 15(a)(1) was never intended to be invoked against innocent purchasers" (Pet. Br. 36 (footnote omitted)). But this is simply not the case.

When it enacted the 1949 amendment to Section 15(a)(1), Congress made clear its understanding that, under existing law, "a purchaser who ships in commerce goods produced by another person who violated the wage-and-hour provisions of the act in the production of such goods, commits an unlawful act." H.R. Rep. 267, 81st Cong., 1st Sess. 39 (1949). See *Amendments to the Fair Labor Standards Act of 1938: Hearings on H.R. 2033 Before the House Comm. on Education and Labor*, 81st Cong., 1st Sess. 690 (1949) (statement of Mr. Forsythe) ("As a general matter, the intent and knowledge of the man who bought [the hot goods] does not matter."). The 1949 amendment was designed to *change* this situation "*to make it lawful* for a purchaser in good faith of goods produced in violation of the act to sell such goods in commerce." H.R. Conf. Rep. 1453, 81st Cong., 1st Sess. 31 (1949) (emphasis added).

Far from confirming any earlier understanding of the FLSA, the 1949 legislation thus created, for the first time, a mechanism by which bona fide purchasers could take steps to "protect themselves from unintentionally violating the act by shipping such so-called 'hot goods' in commerce" (H.R. Rep. 267, *supra*, at 39).[18] In this way, the 1949 amendment—

[18] Petitioner's failure to appreciate this may stem in part from its misstatement of the 1949 enforcement policy of the Department of Labor's Wage and Hour Division, which evidently inspired the 1949 amendment of Section 15(a)(1). As petitioner explains it, "[t]he Administrator had asserted

notwithstanding petitioner's bald assertion to the contrary (Pet. Br. 37)—carved out a narrow exception to Section 15(a)(1). As the Conference Report explained, the amendment imposed "[a]n affirmative duty * * * upon [the purchaser] to assure himself that the goods in question were produced in compliance with the act, and he must have secured written

that certain ordinary commercial purchasers would be subject to injunction under Section 15(a)(1), if they failed to 'police' their vendors' compliance with the wage and hour provisions of the FLSA" (Pet. Br. 33 (footnote omitted)). Petitioner also maintains that "the Administrator at least recognized that Congress never intended Section 15(a)(1) to be invoked against a person who acquired hot goods, innocently and in good faith" (Pet. Br. 34). The first of these statements is misleading and the second is incorrect. In fact, the Administrator "of course[] recognize[d]" that if the purchaser "neither knew nor had reason to think that the goods he purchased were produced in violation of the Act, he should not be accused of wilfully violating" Section 15(a)(1), and therefore would not be subject to *criminal* prosecution. But the Administrator added that "even if there has been no knowledge the statute makes it unlawful to ship any 'hot goods' in interstate commerce, the Division has no choice but to stop the movement of the goods in interstate commerce." "Insurance Against 'Hot Goods,'" *reprinted in* BNA *Wage and Hour Manual* 937 (Cum. 1945). The Administrator therefore suggested that purchasers "police" their suppliers as a "precaution[]" to eliminate the "possibility that [they] may be receiving 'hot goods' with which [they] may be 'stuck'" (*id.* at 938); such policing would provide a "means of protection" so that a purchaser would not "find himself with 'hot goods' on hand which he cannot ship across State lines" (*id.* at 937). By instead permitting the purchaser to rely on the supplier's written assurance of compliance with the FLSA, the 1949 amendment to Section 15(a)(1) simply provided purchasers with a less burdensome means of "protect[ing] themselves from unintentionally violating the act." H.R. Rep. 267, *supra*, at 3?.

assurance to that effect from the producer of the goods." H.R. Conf. Rep. 1453, *supra*, at 31.[19] If Congress had wanted to create a broader exemption for *all* good faith purchasers, or for secured creditors, it surely knew how to do so: "The idea which is now sought to be read into [the FLSA] is not so complicated nor is English speech so poor that the words were not easily available to express the idea or at least to suggest it." *Holly Hill*, 322 U.S. at 618.

3. *Legislative Policy*. a. Like petitioner's analysis of the legislative history, its lengthy and labored discussion of the statutory purpose is simply beside the point, given the unambiguous statutory language: "The 'plain purpose' of legislation * * * is determined in the first instance with reference to the plain language of the statute itself," so that "[i]nvocation of the 'plain purpose' * * * at the expense of the terms of

[19] Statements made at the hearings that preceded the enactment of the 1949 amendment of Section 15(a)(1), upon which petitioner principally relies (see Pet. Br. 35, 37-38), are, to put it charitably, opaque; those statements certainly do not establish that "Congressmen unequivocally confirmed that the Administrator's reading of Section 15(a)(1) swept far too broadly" (Pet. Br. 35). At best, the hearing transcripts indicate that certain congressmen were concerned that the FLSA "provided no method whatsoever for cooling off [hot] goods." *Amendments to the Fair Labor Standards Act of 1938: Hearings on H.R. 2033 Before the House Comm. on Education and Labor*, 81st Cong., 1st Sess. 689 (1949) (*1949 Hearings*) (statement of Rep. Barden); see *id.* at 688 (statement of Rep. Barden). Congress essentially remedied this problem by permitting purchasers to insulate themselves from the operation of Section 15(a)(1) through reliance on a written assurance of compliance with the FLSA. Other congressmen quoted by petitioner evidently were concerned about the possible prosecution of innocent shippers of hot goods. See *1949 Hearings* 690 (statement of Rep. Jacobs).

the statute * * * prevents the effectuation of congressional intent." *Board of Governors* v. *Dimension Financial Corp.*, No. 84-1274 (Jan. 22, 1986), slip op. 12. But even on its own terms, petitioners' analysis is off the mark. In fact, the court of appeals' literal reading of Section 15(a)(1) is entirely consistent with the policy of the FLSA.

This Court has repeatedly explained that "the goal [of the Act is to] outlaw[] from interstate commerce goods produced under conditions that fall below minimum standards of decency." *Tony & Susan Alamo Foundation*, 471 U.S. at 296. See *United States* v. *Darby*, 312 U.S. 100, 117 (1941). To this end, Section 15(a)(1) prohibits the interstate shipment of goods produced in violation of the Act. In doing so, the provision serves several fundamental statutory purposes. The prospect that such products will be barred from interstate commerce provides a strong incentive for employers to adhere to the Act's minimum wage and overtime provisions. See *Darby*, 312 U.S. at 115; *United States Cartridge Co.*, 339 U.S. at 510. And the actual removal of the products from commerce overcomes the unfair competitive advantage that would otherwise be enjoyed by sellers of cheaply produced hot goods.[20]

[20] Petitioner is incorrect in asserting that "Congress was concerned about competitors only to the extent that competition from 'chiselers' had the effect of driving wages down" (Pet. Br. 24-25 (footnote omitted)). The possibility of such a phenomenon certainly was one congressional concern, as the material cited by petitioner indicates. But the congressional findings and declaration of policy also expressly state that failure to pay an adequate wage "constitutes an unfair method of competition in commerce" (29 U.S.C. 202(a)(3)) that the Act was designed to combat. The drafters of the FLSA reiterated in committee reports (see H.R. Conf. Rep. 2738, *supra*, at 17; H.R. Rep. 1452, *supra*, at 16), and on the floor of Congress (see, *e.g.*, 81 Cong. Rec. 7651 (1937) (statement of Sen. Black); *ibid.* (statement of Sen. Walsh)) that "one of the objectives of the bill is that the progressive employer in good standing not be subjected in the public market to competition with chiselers and sweatshop operators" (*ibid.*). See *1937 Joint Hearings* 3, 15, 37, 51, 55 (statement of Ass't Att'y Gen. Robert H. Jackson); *id.* at 17 (statement of Sen. Pepper); *id.* at 183-184 (statement of Secretary of Labor Frances Perkins). This Court thus has rejected the contention that, "while the prohibition [in Section 15(a)(1)] is nominally a regulation of the commerce its [real] purpose is regulation of wages and hours." *Darby*, 312 U.S. at 113. Instead, the Court has noted Congress's finding that "substandard wages and excessive hours, when imposed on employees of a company shipping goods into other States, gave the exporting company an advantage over companies in the exporting States. Having so found, Congress decided as a matter of policy that such an advantage in interstate competition was an 'unfair' one, and one that had the *additional* undesirable effect of driving down labor conditions in the importing States." *Maryland* v. *Wirtz*, 392 U.S. 183, 189 (1968) (emphasis added; footnote omitted). See *Darby*, 312 U.S. at 109-110, 122.

At the same time, the exclusion from interstate commerce of goods produced under substandard conditions is more than a simple enforcement mechanism to achieve other statutory aims: it is itself one of the purposes of the FLSA. President Roosevelt, in a message to Congress that inspired passage of the Act (see H.R. Rep. 1452, *supra*, at 8; S. Rep. 884, *supra*, at 1-3), declared flatly that "[g]oods produced under conditions which do not meet rudimentary standards of decency should be regarded as contraband and ought not to be allowed to pollute the channels of interstate trade." H.R. Doc. 255, 75th Cong., 1st Sess. 3 (1937). See *1937 Joint Hearings* 8 (statement of Ass't Att'y Gen. Robert H. Jackson); *id.* at

177 (statement of Secretary of Labor Frances Perkins). Not surprisingly, this Court's earliest interpretation of the FLSA accordingly announced that one "obvious purpose of the Act" was to "prevent the interstate transportation of the proscribed product." *Darby*, 312 U.S. at 117.

b. All of these statutory purposes are furthered by the ruling below. Most obviously, of course, applying Section 15(a)(1) to petitioner serves "to lessen * * * the distribution in commerce of goods produced under subnormal labor conditions." *Rutherford Food Corp.* v. *McComb*, 331 U.S. 722, 727 (1947).[21] But a literal reading of Section 15(a)(1) also serves the Act's other purposes.

The court of appeals' ruling supplies a strong incentive, both for employers to comply and for creditors that closely oversee the operations of employers to insist on compliance, with the FLSA's minimum wage and overtime provisions. By applying Section 15(a)(1) to hot goods after they leave the producer's hands, a literal reading of the provision puts struggling employers like Ely (and their creditors) on notice that failure to pay employees is not an appropriate (or profitable) means of cutting costs and

[21] That the court of appeals permitted petitioner to sell the goods on the condition that it compensate the unpaid employees if Section 15(a)(1) is found applicable does not undercut the court's recognition (see Pet. App. 7a) that hot goods are contraband. By requiring petitioner to hold an amount equal to the value of the unpaid wages in escrow pending resolution of this case, the court explained that it had "effectively removed the 'taint' from the goods" (*id.* at 10a n.9). In any event, petitioner may not invoke this practical accommodation, made at its request, permitting it to substitute cash for tangible collateral, as determinative of any legal issue in the case. See page 40, *infra*.

that continuing to extract employee labor for which the employer has no means of paying is not an acceptable practice. Such employers will know that goods produced by unpaid employees have a significantly reduced value both for prospective purchasers and for lenders who otherwise might provide inventory-backed financing. A literal application of Section 15(a)(1) also reduces the incentive that creditors would otherwise have to encourage the continuation of manufacturing operations (and the production of collateral) under conditions where employees will likely not be paid. As the Western District court noted below, "if foreclosing creditors are free to ship and sell tainted goods across state lines, the temptation to overextend credit to marginal producers is strong, as is the likelihood that such producers will become unable to meet their payrolls" (Pet. App. 24a).

More generally, reading Section 15(a)(1) to reach "any person" holding hot goods eliminates the financial advantages that creditors like petitioner would otherwise obtain from the failure of debtors to comply with the Act. By liquidating finished goods rather than bulk raw materials, petitioner is benefiting from the labor of Ely's employees. And while it may not actually have colluded in Ely's failure to comply with the Act, petitioner—unlike those employees—was aware both of Ely's precarious financial condition and of the termination of the financing agreement that had previously made it possible for Ely to meet its payroll. In these circumstances, the FLSA, which was enacted to "protect the fundamental interests of free labor" (H.R. Doc. 255, *supra*, at 3 (President Roosevelt's Message of May 24, 1937)), should not be read to give petitioner the benefit of Ely's violation

of the Act. See generally *A.H. Phillips Inc.* v. *Walling*, 324 U.S. 490, 493 (1945).

C. Section 15(a)(1) Does Not Establish a Lien For Employee Wages, And Does Not Conflict With State Insolvency or Federal Bankruptcy Law

Given the clarity of the statutory language and legislative history, it is understandable that petitioner is ultimately forced to look outside the terms and purposes of the FLSA to find arguments that support its narrow construction of Section 15(a)(1). This effort leads petitioner to contend (see Pet. Br. 13-16, 38-45) that Section 15(a)(1), applied literally, would create a "secret" lien for employee wage claims that would interfere with the creditor rights and priorities otherwise established by state and federal law. Petitioner makes this argument because, it suggests, Section 15(a)(1) was applied by the court of appeals "to address the relative priority of creditors' claims against insolvent debtors" (Pet. Br. 38). But this analysis of the decision below fundamentally misunderstands the purpose and application of the FLSA.[22]

1. Section 15(a)(1) is not—and was not interpreted by the courts below to be—at all concerned with the enforcement or priority of creditors' claims. As the courts below noted, the Secretary's action against petitioner "[was] brought, not to compel the foreclosing creditor to pay the statutory wages * * *

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[22] Given the clarity of the FLSA's language and the breadth of its purposes, however, it is manifest that the court of appeals' reading of Section 15(a)(1) would be appropriate even if that reading could be said to displace state insolvency laws. See generally *Rose* v. *Arkansas State Police,* No. 85-1388 (Nov. 3, 1986) (per curiam).

but to keep tainted goods from entering the channels of interstate commerce" (Pet. App. 24a). Petitioner still " 'owns' the goods. The 'hot goods' provision merely prevents [petitioner] from shipping, delivering or selling the goods in interstate commerce" (*id.* at 10a). The rulings below did not alter petitioner's rights in the collateral as against Ely, give Ely's employees any ownership interest in the property, or establish a lien of any sort on the collateral. Instead, the court of appeals simply recognized that Section 15(a)(1) imposes a specific restriction, grounded in public policy, on the shipment of "tainted" goods by anyone. The court ruled only that the restriction remains applicable to the goods when they pass from the manufacturer to a foreclosing creditor.

The fact that one set of beneficiaries of the statute also became creditors of the employer (because they have wage claims), and the fact that this particular employer apparently is unable to pay all its debts, are incidental to the ruling below. Section 15(a)(1) has other beneficiaries—including competing manufacturers and their employees, who are protected against the entry of Ely's hot goods into interstate commerce—and the ruling below would be equally necessary and correct if Ely were solvent and had simply declined to pay either its employees or petitioner.

There are numerous similar laws, "hav[ing] the quality of police regulations" (*Kentucky Whip & Collar Co.* v. *Illinois Cent. R.R.*, 299 U.S. 334, 347 (1937)), that create restrictions to which *all* interests in covered property are subordinated. Long before the enactment of the FLSA, this Court had recognized Congress's plenary power under the Commerce Clause to exclude various goods altogether

from interstate commerce because they are inherently harmful (see, *e.g.*, *Hipolite Egg Co.* v. *United States*, 220 U.S. 45 (1911)), or because the purpose of the commerce is improper (see, *e.g.*, *Lottery Case*, 188 U.S. 321 (1903)), or because, as here, commerce in the goods is inconsistent with congressional policy (see, *e.g.*, *Kentucky Whip & Collar Co.* v. *Illinois Cent. R.R.*, *supra*). Congress typically achieves these regulatory purposes, as it did in the FLSA, by prohibiting "any person" from introducing into commerce goods that were not produced in conformity with the legislative standards.[23] These prohibitions generally are enforceable, as they are in the FLSA, by the threat of an injunctive action or criminal penalties.[24] And such general regulatory laws plainly are not, as petitioner asserts, transformed into laws dealing with "creditors' rights" simply because they may be applied against an entity that happens to be a creditor.

2. As the courts below observed, the FLSA is one of these generally applicable "laws of the land" (Pet. App. 32a; see *id.* at 25a), which merely "add[s] to the list of interstate contraband what Justice Holmes in his dissent [in *Hammer* v. *Dagenhart*, 247 U.S. 251, 280 (1918)] so aptly called the 'product of ruined lives.'" *1937 Joint Hearings* 8 (statement of

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[23] See, *e.g.*, 15 U.S.C. 1191(a), 1192 (Flammable Fabrics Act); 15 U.S.C. 1211 (household refrigerators); 15 U.S.C. 1261(e), 1263(a)-(c) and (f) (Federal Hazardous Substances Act); 21 U.S.C. 321(e), 331(a)-(e) (Food, Drug and Cosmetic Act); 21 U.S.C. 453(j), 458(a)(2)-(4) (Poultry Products Inspection Act).

[24] See, *e.g.*, 15 U.S.C. 1194(b), 1195(a), 1196; 15 U.S.C. 1212; 15 U.S.C. 1264, 1267; 21 U.S.C. 332, 333; 21 U.S.C. 461, 467c.

Ass't Att'y Gen. Robert H. Jackson). Section 15(a)(1) effectuates the congressional policy of "excluding from interstate commerce all goods * * * which do not conform to the specified labor standards." *Darby*, 312 U.S. at 121. Thus, an action by the Secretary for injunctive relief under Section 17 of the FLSA, 29 U.S.C. 217, is designed "not to collect a debt but rather to redress a wrong being done to the public good" (*Donovan* v. *University of Texas*, 643 F.2d 1201, 1208 (5th Cir. 1981) (citation omitted)); it protects the public generally from "the spread of substandard labor conditions." *Darby*, 312 U.S. at 122. The purpose of such a suit is not to obtain funds "owed by an employer to his employee but to correct a continuing offense against the public interest." *Wirtz* v. *Jones*, 340 F.2d 901, 903-904 (5th Cir. 1965). See *Hodgson* v. *YB Quezada*, 498 F.2d 5, 6 (9th Cir. 1974); *Hodgson* v. *Wheaton Glass Co.*, 446 F.2d 527, 535-536 (3d Cir. 1971).[25] Indeed, if an employee refuses to accept back pay that is awarded in a Section 17 action brought by the Secretary, the funds are not returned to the offending employer. See *University of Texas*, 643 F.2d at 1208 n.16; *Burk Builders, Inc.* v. *Wirtz*, 355 F.2d 451, 453 (5th Cir. 1966). Cf. *YB Quezada*, 498 F.2d at 6; *Wheaton Glass Co.*, 446 F.2d at 536.

Obviously, an injunctive action brought by the Secretary against the owner of hot goods has an

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[25] See generally *Donovan* v. *Brown Equipment & Service Tools, Inc.*, 666 F.2d 148, 156-157 (5th Cir. 1982); *Donovan* v. *TMC Industries, Ltd.*, 95 Lab. Cas. (CCH) ¶ 34,278, at 44,976 (N.D. Ga. 1982); *Brennan* v. *T & T Trucking, Inc.*, 396 F. Supp. 615, 618 (N.D. Okla. 1975); *Wirtz* v. *Robert E. Bob Adair, Inc.*, 224 F. Supp. 750, 756 (W.D. Ark 1963); *Wirtz* v. *Alapaha Yellow Pine Products, Inc.*, 217 F. Supp. 465, 470 (M.D. Ga. 1963).

effect on the owner's ability to dispose of the property as he would like. But that effect cannot be said to disturb the relative priority of creditors, any more than does the operation of the Flammable Fabrics Act or some other statute (see note 23, *supra*) that prohibits the introduction into commerce of dangerous or defective goods. A secured creditor who obtained through foreclosure goods that subsequently failed to meet the standards of the Flammable Fabrics Act, for example, could hardly argue that that Act was in tension with state insolvency law and therefore should be construed not to reach secured creditors. Yet petitioner is making an essentially identical argument here; there is no difference in principle between the owner of flammable fabrics and the owner of hot goods.

To be sure, petitioner may cure the taint here by paying an amount equivalent to the minimum wages and overtime compensation that were wrongfully withheld from Ely's employees. But that possibility does not give Ely's employees a "claim" on the employer's assets that has "priority" over the claims of a secured creditor. The taint here arose because Ely's goods were produced under substandard labor conditions; paying the employees now may be said to remove the taint by, in a sense, retroactively altering those conditions. The hot goods thus are "cooled" by addressing the employer's employment practices, rather than by remedying a defect in the goods themselves.[26] That distinction, however, does not change

[26] Other statutes that parallel the FLSA in barring defective goods from commerce also, like the FLSA, permit sale or shipment of the goods if the defect is cured. See, *e.g.*, 15 U.S.C. 1195(d); 15 U.S.C. 1265(c); 21 U.S.C. 334(d); 21 U.S.C. 467b(a).

the essential character of a lawsuit by the Secretary under Section 17: such a suit "cannot be deemed a representative action on behalf of the individual employees" (*University of Texas*, 643 F.2d at 1206), and remains "primarily in the public interest" (*id.* at 1208). "The employer has violated a federal statute, it has not merely breached a private agreement, and it is the enforcement of the statute, not compliance with a private contract that concerns the Secretary." *Donovan* v. *TMC Industries, Ltd.*, 95 Lab. Cas. (CCH) ¶ 34,278, at 44,980 (N.D. Ga. 1982) (footnote omitted).

At bottom, then, petitioner's argument that Section 15(a)(1) creates a lien founders on the settled principle that a foreclosing creditor does not obtain greater rights in the collateral than his debtor had. Ely failed to comply with the FLSA and therefore could not have shipped its hot goods in interstate commerce. Petitioner—which, the courts below found, knew it was funding Ely's payroll (Pet. App. 19a) and which continued monitoring Ely's production even after the financing agreement was terminated—should not have expected to gain greater rights when it took possession of the property. Nor does a literal reading of the FLSA make the extension of credit unduly hazardous: lenders routinely monitor their borrowers' activities closely to ensure that the borrowers comply with both public law and their obligations to other creditors, lest a legal bar or a superior lien (for taxes, to a supplier, or to employees) interfere with the exercise of the lender's rights. Indeed, as the court of appeals noted, petitioner received "various daily, weekly, and monthly reports" from Ely (Pet. App. 2a). And petitioner scrutinized the data with which it was most concerned, including

Ely's accounts receivable, inventory—and payroll taxes.

3. Petitioner's contention (Pet. Br. 42-44) that a literal application of the FLSA will interfere with the operation of the Bankruptcy Code is similarly mistaken. First, that contention is out-of-place here, since Ely never filed for bankruptcy. More fundamentally, as the court of appeals observed, "[t]he holding [in this case] does not change the priorities in bankruptcy" (Pet. App. 10a). As we noted above, the ruling below did not give Ely's employees any rights in Ely's estate; it simply allowed the Secretary to keep tainted goods out of interstate commerce.

The Bankruptcy Code itself expressly recognizes the distinction between the enforcement of general regulatory laws like the FLSA, which serve the broad public interest, and the enforcement of creditors' rights. Section 3(b)(4) of the Code, 11 U.S.C. 362 (b)(4), excepts exercises of a "governmental unit's police or regulatory power" from the automatic stay otherwise imposed by Section 3(a)(1), 11 U.S.C. 362 (a)(1), on proceedings against a debtor to collect pre-petition debts. Thus, "where a governmental unit is suing a debtor to prevent or stop a violation of * * * police or regulatory laws, or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under the automatic stay." S. Rep. 95-989, 95th Cong., 2d Sess. 52 (1978).[27]

[27] Section 3(b)(4), 11 U.S.C. 362(b)(4), has been held to except enforcement of a wide range of regulatory and police measures from the automatic stay. See, *e.g.*, *NLRB* v. *Edward Cooper Painting Inc.*, 804 F.2d 934 (6th Cir. 1986) (unfair labor practice proceedings even where back pay is sought); *Cournoyer* v. *Town of Lincoln*, 790 F.2d 971 (1st Cir. 1986) (enforcement of zoning ordinance); *Penn Terra Limited* v.

Similarly, Section 3(b)(5) of the Code, 11 U.S.C. 362(b)(5), excepts "the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce * * * [its] police or regulatory power" from the usual stay imposed on actions to enforce judgments against debtors (see Section 3(a)(2), 11 U.S.C. 362 (a)(2)). This exception permits "enforcement of an injunction and * * * permit[s] the entry of a money judgment, but does not extend to permit enforcement of a money judgment." S. Rep. 95-989, *supra*, at 52. See generally *Midlantic Nat'l Bank* v. *New Jersey Dep't of Environmental Protection*, No. 84-801 (Jan. 27, 1986), slip op. 8-10.

Section 362(b)(4) is fully applicable to FLSA hot goods cases.[28] Relying on the broad public welfare

Dep't of Environmental Resources, 733 F.2d 267 (3d Cir. 1984) (injunction requiring debtor to correct violations of state environmental protection statutes); *Commodity Futures Trading Comm'n* v. *Income, Inc.*, 649 F.2d 128 (2d Cir. 1981) (providing Commodity Futures Trading Commission access to debtor's books and records); *In re Mansfield Tire & Rubber Co.*, 660 F.2d 1108 (6th Cir. 1981) (administration of state workers' compensation law); *NLRB* v. *Evans Plumbing Co.*, 639 F.2d 291 (5th Cir. 1981) (petition seeking reinstatement and back pay for discriminatorily discharged employees).

[28] Petitioner attempts to find significance in Congress's decision to delete trustees in bankruptcy from the list of entities included as "person[s]" in Section 3(a) of the Act (Pet. Br. 18 n.20). This argument is without merit. The version of the FLSA originally introduced in the Senate defined "person" to include "an individual, partnership, association, corporation, business trust, receiver, trustee, trustee in bankruptcy, or liquidating or reorganizing agent." S. 2475, *supra*, § 2(a)(1). The House substituted the following version, which appears in the present Act: "'Person' means an individual, partnership, association, corporation, business trust,

purposes underlying the FLSA in general and Section 15 and Section 17 in particular, the district and bankruptcy courts have uniformly concluded that enforcement proceedings under Section 17 fall within the Section 362(b)(4) exception. See *Donovan* v. *Health Care Resources, Inc.*, 102 Lab. Cas. (CCH) ¶ 34,596, at 46,505-46,506 (W.D. Mo. 1984); *TMC Industries*, 95 Lab. Cas. ¶ 34,278, at 44,979-44,981; *Donovan* v. *Timbers of Woodstock Restaurant, Inc.*, 93 Lab. Cas. (CCH) ¶ 34,155, at 44,426 (N.D. Ill. 1981); *In re Tauscher*, 24 Wage & Hour Cas. (BNA) 1310, 1311-1312 (Bankr. E.D. Wis. 1981). Cf. *Brennan* v. *T & T Trucking, Inc.*, 396 F. Supp. 615, 618 (N.D. Okla. 1975). As construed by the courts in these cases, Section 362(b)(4) permits the government to enforce the FLSA "without regard to the debtor's position in the bankruptcy court." *TMC Industries*, 95 Lab. Cas. ¶ 34,278, at 44,977.[29]

legal representative, or any organized group of persons." 29 U.S.C. 203(a) (emphasis added). Congress thus substituted the inclusive term "legal representative" for the narrower categories listed in the Senate bill.

[29] Petitioner's suggestion (Pet. Br. 43) that the liquidation of bankrupt estates will be impeded if trustees are enjoined from selling hot goods is frivolous: such an application of the FLSA no more conflicts with the bankruptcy laws than does the Flammable Fabrics Act. The asserted conflicts between Section 15(a)(1) and the other federal laws cited by petitioner (Pet. Br. 44-45) are also in equal parts hypothetical and illusory. This case does not, of course, involve the Federal Tax Lien Act of 1966, the Packers and Stockyards Act, or the Perishable Agricultural Commodities Act. See *Ruckleshaus* v. *Monsanto Co.*, 467 U.S. 986, 1018 (1984). And the FLSA could not, in any event, conflict with those statutes. The Packers and Stockyards Act creates a trust in meat (and proceeds from its sale) in favor of all unpaid sellers of livestock (7 U.S.C. 196(b)), giving such sellers priority over

4. Finally, petitioner's contention (Pet. Br. 46-49) that this Court should not disturb the construction of the FLSA set out in *Powell Knitting Mills* is without merit. A single court of appeals'[30] 20-year-old, plainly erroneous interpretation of a significant federal statute is far from dispositive. Cf. *United States* v. *Mendoza*, 464 U.S. 154, 160-163 (1984). That interpretation, moreover, can hardly be said to have been accepted (or, for that matter, noticed) by Congress, which has not amended Section 15(a)(1) since 1949. It has not been endorsed by the Secretary, who has brought several enforcement actions against creditors outside the Second Circuit in the intervening years.[31]

secured lenders in bankruptcy (see *In re Gotham Provision Co.*, 669 F.2d 1000 (5th Cir.), cert. denied, 459 U.S. 858 (1982)), and under the Uniform Commercial Code (see *Fillippo* v. *S. Bonaccurso & Sons, Inc.*, 466 F. Supp. 1008, 1022 (E.D. Pa. 1978)). The Perishable Agricultural Commodities Act (7 U.S.C. (Supp. III) 499e(c)), was patterned after the Packers and Stockyards Act and affords sellers of such commodities the same protections. See *In re Fresh Approach, Inc.*, 48 Bankr. 926 (Bankr. N.D. Tex. 1985). The FLSA, unlike those statutes, does not create a lien and therefore does not displace otherwise applicable lien priorities, any more than would a statute prohibiting the sale of tainted meat by an insolvent stockyard. And there can be no conflict between the FLSA and the Federal Tax Lien Act, Pub. L. No. 89-719, 80 Stat. 1125 *et seq.*, because the United States is not a "person" within the meaning of Section 15(a)(1). See 29 U.S.C. 203(a).

[30] The holding of *Powell Knitting Mills* was followed by the Fourth Circuit without analysis. *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971).

[31] In addition to the actions below, see *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971); *Dunlop* v. *Sportsmasters, Inc.*, 77 Lab. Cas. (CCH) ¶ 33,293 (E.D. Tenn. 1975); *Brock* v. *Kentucky Ridge Mining Co.*, C.A. No. 85-0180-O(M) (W.D. Ky. Oct. 11, 1985); *Brock* v. *LTW Sportswear, Inc.*, C.A. No. 2-86-907 (M.D. Tenn. Aug. 22 and 29,

And the *Powell Knitting Mills* analysis—which established an open-ended and concededly (see 360 F.2d at 733) inexact exemption from Section 15(a)(1) for certain owners of hot goods—does not set out the "bright line" rule sought by petitioner (Pet. Br. 48). Such a rule is found, instead, in the plain language of Section 15(a)(1), which flatly bars the interstate shipment of hot goods by "any person."

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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and Sept. 18, 1986) (secured creditor dismissed other paying back wages). See also *Donovan* v. *Standard Forge & Axle Co.*, C.A. No. 84-T-13 74 N (M.D. Ala. dismissed Nov. 15, 1984) (secured creditor intervened as defendant; action settled after preliminary injunction issued); *Donovan* v. *Fabrics America, Inc.*, C.A. No. 82-245-S (M.D. Ala. dismissed Jan. 12, 1984) (same).

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No. 86-88

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Supreme Court of the United States
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CITICORP INDUSTRIAL CREDIT, INC.,
Petitioner,

v.

WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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REPLY BRIEF FOR THE PETITIONERS

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This case is about the competing claims of creditors to the assets of an insolvent debtor—not a dispute between an employer and its employees as to wages due. Accordingly, the question presented is whether in enacting the Fair Labor Standards Act of 1938, Congress intended to alter the priority of creditors' claims against the assets of an insolvent.

Neither the Secretary nor *amicus* AFL-CIO cites any evidence that Congress intended to address the consequences of insolvency or to preempt state law traditionally governing the priority of creditors' claims. No decision of this Court requires that the purpose of the FLSA or common sense be ignored in determining the reach of Section 15(a)(1). The "familiar rule, that a thing may be within the letter of a statute and yet not within the statute, because not within its spirit, nor within the intention of its makers," *Church of the Holy Trinity* v. *United States*,

143 U.S. 457, 459 (1892), precludes any such approach to statutory interpretation. See, *e.g.*, *California Federal Savings and Loan Association* v. *Guerra*, 107 S. Ct. 683, 691 (1987). When read in light of the history and purpose of the FLSA, it is evident that Congress never intended Section 15(a)(1) to be used to coerce an *innocent secured creditor* to pay the wages of its insolvent debtor's employees as a condition of enforcing its security interest.[1]

1. The Secretary and *amicus* AFL-CIO assert that because the FLSA does not create an express "lien," it does not conflict with the priority of creditors' claims established by state and other federal law.[2] The Secretary denies that this action was brought to force payment of employee wages, and asserts that Citicorp's rights in the inventory collateral as against other Ely creditors have not been altered.[3] Labelling the judicially created prior charge against inventory to secure payment of wage claims something other than a "lien" does not change economic reality. Nor does the label mitigate in the slightest the conflict between the court of appeals' holding and the requirements of state and other federal law (such as the Bankruptcy Code) governing the priority of creditors' claims against insolvent debtors.

The economic reality is that $1.5 million of the proceeds of the sale of Citicorp's collateral is in escrow for the payment of a group of unsecured Ely creditors, namely, Ely's employees. Citicorp's perfected security interest in the inventory collateral is undisputed. Under

[1] The district courts found that *both* Citicorp and the employees were "*innocent parties*." Pet. App. 25a-26a; 32a (emphasis added); *see also* Pet. App. 10a. Accordingly, the Secretary's thinly veiled suggestions that Citicorp was in any way complicit in Ely's failure to pay its employees are baseless and unwarranted. *E.g.*, Resp. Br. 9, 35, 41. The same is true of *amicus* AFL-CIO's blatant arguments to that effect. AFL-CIO Br. 26-27.

[2] Resp. Br. 14, 44-45 n.29; AFL-CIO Br. 3-4, 20-23.

[3] Resp. Br. 14.

Article 9 of the Uniform Commercial Code, therefore, Citicorp would have been entitled to satisfaction of its entire claim out of the proceeds of sale before there was anything to be distributed to other creditors. In contrast, the court of appeals' construction of Section 15(a)(1) requires that unsecured employee wage claims be paid first, ahead of secured claims.

In the district court, the Secretary's counsel admitted that the purpose of this action was to "pressure" Citicorp (and the insolvent employer) to pay employee wages, and further that the effect of entering an injunction against Citicorp was to create a "priority" for employee wage claims. See Pet. Br. 7 & n.7. The district court succinctly summarized the Secretary's position: "a creditor has no lien ahead of the payroll." C.A. App. 67. That proposition is squarely at odds with the entire jurisprudence of insolvent estates and secured transactions. Whatever label is used to characterize the Sixth Circuit's conclusion, the effect is to impose a prior charge on the inventory to secure payment of employee wage claims.[4]

Contrary to the Secretary's assertion, Ely's insolvency and the employees' status as creditors are not "incidental" (Resp. Br. 37), but central. The transparent purpose and obvious effect of this lawsuit was to force a secured creditor of an insolvent debtor to pay the junior claims of some unsecured creditors, contrary to the order of priority generally prescribed under state law. The Secretary's reliance (Resp. Br. 38-40) on the Flammable Fabrics Act and other federal statutes that have different purposes and effects is misplaced: those statutes do not require one creditor to pay the claims

[4] Citicorp had no independent obligation to pay the wages of Ely's employees. The sole basis for requiring Citicorp to pay the wage claims is its possession of the inventory. Accordingly, the wage claims represent an effective surcharge against the inventory. *See* Pet. Br. 4 n.4 (definition of "lien"). The suggestion that Citicorp was free to refuse to pay the wages and permit the goods to sit in a warehouse and become worthless is correct, but unhelpful. *See* Resp. Br. 37.

of another, and they are intended to further other federal policies such as health and safety.

In determining whether Congress intended the FLSA to displace state law governing the consequences of insolvency, the federal bankruptcy law in effect when the FLSA was enacted and today is much closer to the mark. Congress specifically addressed the consequences of insolvency. Like Article 9 of the Uniform Commercial Code, federal bankruptcy law expressly recognizes the validity of prior perfected liens as against unsecured wage claims. Pet. Br. 23 n.26. Indeed, within days of the effective date of the FLSA, Congress amended the bankruptcy law affirming the protection accorded prior lienholders over employee wage claims. The Chandler Act of 1938, 52 Stat. 840. As an indication of whether it is at all likely that the Seventy-Fifth Congress had any intent to elevate the priority of unsecured wage claims over prior valid lienholders in enacting the FLSA, the 1938 bankruptcy legislation is a far better guide than the Flammable Fabrics Act. More recently, Congress enacted two statutes that were intended to modify the claims of creditors against insolvents.[5] The statutes are narrowly drawn to protect two groups of unpaid sellers against all competing claims; in both, the mechanism for protection is a statutory trust, not a procedural form of coercion such as an injunction. The court of appeals' holding stretches the FLSA to govern an area it was never intended to reach, and in so doing puts the FLSA in irreconcilable conflict with at least three federal statutes. Pet. Br. 44-45.[6]

The whole case, then, comes down to this. Under Article 9 of the U.C.C., Citicorp's security interest in Ely's

[5] Packers & Stockyards Act, 7 U.S.C. § 196(b); Perishable Agricultural Commodities Act ("PACA"), 7 U.S.C. § 499e(c). *See* Pet. Br. 44-45.

[6] Under the Sixth Circuit's reading of Section 15(a)(1), a trustee in bankruptcy may be precluded from liquidating the bankrupt's inventory in accordance with the priorities contemplated in the Bankruptcy Code, and the creditors Congress intended to protect in enacting the Packers & Stockyards Act and PACA are subject to

inventory takes priority over unpaid wage claims. If the Secretary wins this case, those priorities will be reversed; state law will be preempted. Further, the order of priority established in the bankruptcy law will be disrupted, and the purpose of the statutory trusts created in the Packers & Stockyards Act and in the Perishable Agricultural Commodities Act will be frustrated. Well established rules governing preemption and repeal by implication prevent such an ouster of state and federal law, except on a clear showing that Congress in fact intended such a result.[7] That is too heavy a burden to be borne on the shoulders of "any person." For reasons set forth in our opening brief (Pet. Br. 14-38), and explained further in this reply, those words addressed quite a different problem.

Even more important, it is agreed on all sides that Congress never considered the question in this case—whether the FLSA should effectively preempt and repeal otherwise applicable laws dealing with insolvency.[8] Yet, a specific, focused, congressional intent is precisely what is required before this Court will hold that state law has been preempted, or federal law implicitly repealed. Congress "will not be deemed to have significantly changed the federal-state balance . . . unless otherwise the purpose of the Act would be defeated." *Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2121 (1986) (plurality opinion). This principle, developed in our opening brief, has been ignored rather than answered. It cannot be answered, and it governs this case.

Doubtless Congress has ample constitutional authority to prohibit interstate transportation of goods deemed

injunction prohibiting recovery of their inventory and related products, whenever a failed business results in unpaid wages, as is almost invariably the case.

[7] *E.g.*, *Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2121 & nn.32-33 (plurality opinion) (1986); *Radzanower* v. *Touche Ross & Co.*, 426 U.S. 148, 154 (1976).

[8] The court of appeals acknowledged that "Congress never directly considered the question whether the 'hot goods' provision [29 U.S.C. § 215(a)(1)] applies to secured creditors." Pet. App. 12a.

harmful or dangerous. *United States* v. *Darby*, 312 U.S. 100 (1941). If Congress concludes that, to further its purposes, any such prohibition should extend to goods in the hands of a secured creditor, state law would be no obstacle. U.S. Const., Art. VI, para. 2. Whether Congress intended the prohibition of Section 15(a)(1) to extend to a secured creditor whose insolvent debtor fails to pay employee wages, however, is a question of statutory interpretation. The government's case falls far short of showing that Congress intended not just to pass a wage and hour law, but also to change existing law governing the priority of creditors' claims.

2. The Secretary asserts that three principal purposes of the FLSA are served by invoking Section 15(a)(1) against an innocent secured creditor of an insolvent employer: (a) to protect against unfair competition, (b) to encourage creditors to police compliance by their debtors, and (c) to exclude from commerce goods produced under substandard conditions.[9]

a. As to the first, if trade regulation was a purpose of the FLSA, that purpose would not be furthered by applying the Act here. Citicorp is not in the clothing business; its *only* interest in the Ely inventory is as security for $9.5 million advanced under the loan agreement. To minimize its loss on the loans, Citicorp must sell the goods at the best price it can obtain in the market. Whether Ely's cost of producing the goods included payroll expense or any other expense does not affect the market price. The creditor must sell in a commercially reasonable manner under the Uniform Commercial Code, §§ 9-504, 9-507. There is no incentive to sell the goods at a discount solely because its debtor failed to pay for some

[9] *See* Resp. Br. 31-37; *see also* AFL-CIO Br. 8 n.3. The sole purpose of the FLSA was to establish decent wages. Pet. Br. 19-22. The effects on commerce identified in Section 2(a) of the Act are the bases for Congress' exercise of its power under the Commerce Clause, not purposes independent of establishing wage and hour standards. Characterizing the elimination of those effects as purposes of the FLSA, however, does not lead to a different result.

labor or materials used in producing the collateral. A secured creditor's sale of collateral thus poses no threat to competition.

b. The Secretary argues that invoking Section 15(a)(1) against a secured creditor will encourage the creditor to police compliance with the Fair Labor Standards Act.[10] Presumably, to justify such an obligation, both the Secretary and *amicus* AFL-CIO emphasize that Citicorp monitored aspects of Ely's business *other than its payroll practices* and that Citicorp advised Ely that no additional funds would be advanced under the financing agreement.[11]

Monitoring by a secured creditor (or, for that matter, by any third party who does not control an employer's payroll practices) *cannot prevent* a violation of the substantive requirements of the FLSA. Moreover, if, as in this case, the failure to pay employee wages was never part of the debtor's business practice, but due to insolvency, monitoring accomplishes nothing. After the missed payroll, a secured creditor has no ability to force the employer to pay, especially when no further loans are being made. See Resp. Br. 18 n.9 (noting futility of action against an insolvent employer).

The financing agreement specifically required Ely to comply with applicable federal and state law requirements. Pet. App. 12a n.11. After Ely's asserted violation, under the Secretary's view, Citicorp's choices were to pay the employees or to forgo its security for the $9.5 million loans. Even if Citicorp had discovered the missed payroll at the same time as the employees, under the Secretary's view, its choices would have been the same.

[10] Resp. Br. Br. 34-35. As discussed in petitioner's opening brief and further below, the argument incorrectly assumes that Congress intended to impose such an obligation. Pet. Br. 26-38; pages 12-17, *infra*.

[11] Resp. Br. 6, 34, 41-42; AFL-CIO Br. 19, 26.

Accordingly, requiring a secured creditor to police compliance by its debtor in these circumstances would not prevent non-payment by the employer, but would only burden the creditor.[12]

Citicorp's knowledge that no additional funds were to be advanced under the financing agreement provides no basis for invoking Section 15(a)(1) to require payment of the employee wages. Apparently, the Secretary believes that Citicorp should be sanctioned for having failed to notify *the employees in addition to notifying the Ely management* that no further funds would be advanced under the agreement, and failing to advise the employees that Ely management might use previous loan proceeds for purposes other than payment of wages. First, Citicorp had no obligation to undertake any such unwarranted interference in Ely's business. More important, Citicorp also knew that Ely might be successful in obtaining alternative financing to pay the wages.

The Secretary asserts that invoking Section 15(a)(1) against an innocent secured creditor eliminates an incentive to encourage continued operations under circumstances where employees are not "likely" to be paid.[13] The Secretary fails to explain when in his judgment it became "likely" that employees would not be paid in this case; nor does the Secretary offer any basis for the implicit assumption that Congress intended to force a business to close when financial difficulties make it "likely" that employees may not be paid. In any event, there is no evidence whatever that Citicorp encouraged Ely to continue operations. As the Secretary acknowledges, Citicorp postponed taking possession of the inventory to permit Ely's management an opportunity to secure alternative financing.[14] If Ely's management had been successful, the employees would have been paid.

Thus, enforcing Section 15(a)(1) against an innocent third party does nothing to encourage compliance by an employer whose failure to pay the minimum wage is due solely to *insolvency*. Any effect on a third party is irrelevant to either the employer's ability to pay or the employer's clear obligation to pay. In addition, it is difficult to conceive of circumstances (and the Secretary suggests none) when punishing the creditor will affect the conduct of the employer *absent* some joint effort to circumvent the Act.

c. At several points, the Secretary suggests (*e.g.*, Resp. Br. 33, 34) that Congress had an *independent* purpose to exclude from commerce goods produced under substandard conditions. That suggestion defies common sense and history. Pet. Br. 19-26. "In the [FLSA], the *primary purpose of Congress was not to regulate interstate commerce as such.* It was to eliminate, as rapidly as practicable, substandard labor conditions throughout the nation. It sought to raise living standards without substantially curtailing employment or earning power." *Powell* v. *United States Cartridge Co.*, 339 U.S. 497, 509-510 (1950); see *id.* 529 (Frankfurter, J., dissenting).[15]

3a. The Secretary correctly observes that a threshold issue in this case is whether an insolvent employer's failure to meet its payroll in the week or two preceding termination of business violates the substantive require-

[12] Further, interference with management decisions by a secured creditor, however laudatory, may result in subordination of the secured creditor's claim or joint liability with the debtor to other creditors. *See* NCFA *Amicus* Br. 15.

[13] Resp. Br. 35.

[14] Resp. Br. 7. There is nothing in the record that indicates that Citicorp knew Ely's management would be unable to obtain alternative financing.

[15] Neither *Darby* nor this Court's more recent decision in *Tony & Susan Alamo Foundation* v. *Secretary of Labor*, 471 U.S. 290 (1985), is to the contrary.

ments of the FLSA.[16] The statute establishes minimum wage rates, and it is directed at "chiselers," not insolvents; the problem Congress addressed was excessively low wages, not the consequences of insolvency. Pet. Br. 19-26. The remedial provisions of the Act (including the provisions for liquidated damages, attorneys fees, and enforcement by the Secretary) are plainly directed at the chiseler, rather than an employer whose failure to pay agreed wages, admittedly in excess of the prescribed minimum, is due solely to insolvency.[17] In short, as the Secretary recognizes (Resp. Br. 18 n.9) the FLSA creates rights and remedies for the benefit of employees that

[16] The court of appeals decided the issue, and it is fairly encompassed by the question presented. Rule 21(1)(a), Rules of the Supreme Court of the United States.

[17] None of the cases cited by the Secretary even addresses the question of whether the Act is properly invoked in such circumstances. In *Torres* v. *American R. Co. of Porto Rico*, 157 F.2d 255 (1st Cir.), *cert. denied sub nom. American R. Co. of Puerto Rico* v. *Romero*, 329 U.S. 782 (1946), the court held that after a violation of the FLSA a release executed upon payment of half the additional wages due does not bar recovery of the balance by an employee under Section 16(b), even if the employer is in financial difficulty. Similarly, the other cases discuss the scope of the district court's power to deny equitable relief because of the potential financial hardship on an employer found to have violated the Act. *See generally Amoco Production Co.* v. *Village of Gambell*, 55 U.S.L.W. 4355, 4358-4359 (1987); *Weinberger* v. *Romero-Barcelo*, 456 U.S. 305, 313 (1982). In *Wirtz* v. *Malthor, Inc.*, 391 F.2d 1 (9th Cir. 1968), the court held that a district court improperly denied an injunction against continued withholding of backpay on the grounds of the employer's good faith violation of the FLSA and the potential financial hardship. In *Hodgson* v. *Taylor*, 439 F.2d 288 (8th Cir. 1971), the court held that financial hardship was insufficient grounds for refusing an injunction under the circumstances. Finally, in *Hodgson* v. *A-1 Ambulance Service, Inc.*, 455 F.2d 372 (8th Cir. 1972), the court concluded that while a district court might properly take into account the financial condition of an employer in determining the terms and conditions for payment of backpay as a condition of purging a civil contempt, the employer's financial difficulties did not warrant refusal to enter an order requiring payment.

are meaningless, as a practical matter, except in the context of an ongoing business. It was passed with "the sole purpose and aim of raising existing wages in the lower wage groups." 82 Cong. Rec. 1395 (Dec. 13, 1937) (Statement of Rep. Randolph).[18]

Even if there were a technical violation of the substantive requirements of the FLSA because no wages were paid during the last pay period as Ely slipped into insolvency, and Ely might have been "enjoined" under Section 15(a)(1) from shipping its inventory until it paid the wages (although that alone might deny the insolvent its last chance to pay the employees), it is clear that such circumstances are far removed from the core concerns that prompted the FLSA. Unless Congress also intended that Section 15(a)(1) be invoked to hold an innocent, good faith secured creditor responsible for such a "violation," the judgment of the Sixth Circuit must be reversed.[19]

[18] This Court's "usual approach to the FLSA" (Resp. Br. 21) does not aid the Secretary here. For this Court's "usual" approach is to construe the FLSA coverage and exception provisions in the context they were intended to govern: wage and hour standards. *See, e.g., Mabee* v. *White Plains Publishing Co.*, 327 U.S. 178 (1946) (rejecting the maxim *de minimis* as basis for excluding a newspaper publisher from coverage); *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U.S. 607, 616-617 (1944) (rejecting Administrator's attempt to limit scope of explicit exception). This Court's "usual" approach to construing the FLSA has never been employed to extend the Act to govern the consequences of insolvency.

[19] Contrary to the Secretary's repeated suggestion that there is no reason Citicorp should be in a better position than Ely (*e.g.*, Resp. Br. 20), it is not at all uncommon for a bona fide, good faith purchaser, without notice to take goods free of claims that would be good against its seller. *See, e.g.*, U.C.C. §§ 2-403, 9-307. Moreover, the reasons Citicorp should be in a better position than Ely are numerous. The most obvious are: (1) if there was a violation of the law, the violation was Ely's, not Citicorp's; (2) Citicorp exercised no control over Ely's payroll practices and thus shares no responsibility for any violation; (3) Citicorp loaned Ely $9.5 million dollars *before any* violation occurred, with no practicable means of recovery except through the security for which it had contracted

b. Unable to show that any purpose of the FLSA is served by enforcing Section 15(a)(1) against an innocent secured creditor, the Secretary asserts that "[t]he text is dispositive." Resp. Br. 12. More specifically, the Secretary argues that the phrase "any person," the common carrier proviso, and the 1949 amendment to Section 15(a)(1) reveal Congress' deliberate intention that the provision be used to force a secured creditor to pay the wages of its insolvent debtor's employees.

This Court's decisions affirm that "the text is only the starting point."[20] "In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy."[21] The "plain language" of a statute always must be evaluated against the background of its history and purpose, for "[i]t is a familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers."[22]

The Secretary does not deny that the legislative history of the Act indicates that the phrase "any person" in Section 15(a)(1) was understood by its draftsmen and explained during the hearings as necessary to avoid circumvention of the substantive provisions of the Act by practices such as subcontracting to sweatshops.[23] Instead,

in good faith; and, as already explained, (4) no purpose of the FLSA is served by punishing Citicorp for Ely's wrong.

[20] *Kelly* v. *Robinson*, 107 S. Ct. 353, 358 (1986); quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring).

[21] *Offshore Logistics, Inc.* v. *Tallentire*, 106 S. Ct. 2485, 2494 (1986) (internal quotation marks and citations omitted).

[22] *Church of the Holy Trinity* v. *United States*, 143 U.S. 457, 459 (1892); *see California Federal Savings & Loan Association* v. *Guerra*, 107 S. Ct. 683, 691 (1987); *United Steelworkers of America* v. *Weber*, 443 U.S. 193, 201 (1979); *see also Jersey Shore State Bank* v. *United States*, 107 S. Ct. 782, 785 (1987) (rejecting literal interpretation of tax notice provision, because inconsistent with Congress' purposes).

[23] Resp. Br. 24-25 n.15. *But cf.* AFL-CIO Br. 11 & n.8.

the Secretary asserts that circumvention *by subcontracting* was not the *only* purpose of the language of Section 15(a)(1). Citicorp never suggested that subcontracting is the only means of circumventing the Act Congress intended to reach. Pet. Br. 26-28. Subcontracting to "sweatshops" is simply the most obvious means of circumvention Congress hoped to address by broadly proscribing the shipment of hot goods in interstate commerce by "any person." The point is that where, as here, nonpayment is due to insolvency, the holder of the goods is wholly innocent of any wrongdoing, and there is *no evidence* of collusion or any attempt to circumvent the substantive requirements of the Act, the case is outside the intended reach of Section 15(a)(1). *See Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971).[24]

[24] The Secretary cites an exchange between George H. Davis, President, Chamber of Commerce of the United States, and Representative Thomas as evidence that Congress understood and intended that Section 15(a)(1) would be invoked against "innocent purchasers without notice." Resp. Br. 25 n.15. The comments suggest precisely the opposite conclusion. In response to Mr. Davis' concern that, as drafted, the predecessor to Section 15(a)(1) might be invoked against "innocent purchasers without notice," Representative Thomas assured him that the concerns were unfounded:

> "In reference to your observations referring to the penalties that may be placed upon the innocent holder of substandard goods, that strikes me most forcibly. However, let me point out to you that perhaps some of your fears are unfounded .... I recall distinctly that the bill specifically provides that the Board shall have authority to excuse and make exceptions where good faith is shown by those who purchase these goods made under substandard conditions.
>
> ....
>
> ... "[I]f you will keep reading the bill, you will find it specifically mentioned in there that *the innocent holder of substandard made goods will be excused.*"

Fair Labor Standards Act of 1937: Joint Hearings on S. 2475 and H.R. 7200 Before the Senate Comm. on Education and Labor and the House Comm. on Labor, 75th Cong., 1st Sess. 941 (1937) (statement of Rep. Thomas); *see id.* 937 (statement of George H. Davis, President, Chamber of Commerce of the United States).

The Secretary further asserts that the "common carrier" proviso of Section 15(a)(1) "would hardly have been necessary if . . . the prohibition was meant to apply only to those responsible for the violation." [25] The common carrier proviso was included to avoid the prospect of having the constitutionality of the Act tested in litigation to which the government was not a party.[26] Any case in which the scope of Section 15(a)(1) was relevant necessarily would have involved the government, since no one else could file suit to enforce the provision. Accordingly, the common carrier proviso can provide no basis for inference as to the intended scope of Section 15. The proviso certainly does not reflect any congressional intention that Section 15(a)(1) be invoked to punish any other innocent, third party in possession of "hot goods." It was not an "exemption" to Section 15(a)(1), and sheds no light on its meaning.

The Secretary further observes that "Congress devoted considerable attention to the specific question whether 'innocent' purchasers of hot goods should be exempted from Section 15(a)(1)." Resp. Br. 25. All the more telling in light of that fact, is the failure of either the Secretary or *amicus* AFL-CIO to cite even one "snippet" of legislative history suggesting that *anyone thought it appropriate* that innocent purchasers *should be subject* to injunction under Section 15(a)(1) or, conversely, that exemption of such purchasers was inappropriate. The Secretary suggests that the omission of the proposed

[25] Resp. Br. 19. As noted, Citicorp's position never has been that Section 15(a)(1) is applicable only to employers. It was intended to apply to employers as well as to those acting in collusion with the employer to circumvent the substantive provisions of the Act. Pet. Br. 26-28.

[26] The common carrier proviso was intended "to prevent a case involving the constitutionality of the Act from arising in a suit between a shipper and a common carrier, to which the Government was not a party, inasmuch as the common carrier has no interest in the issue of constitutionality, but only in its obligation to accept goods for transportation." H.R. Rep. No. 2182, 75th Cong., 3d Sess. 14 (1938).

"exemption" provision in 1938, without more, supports the view that Congress considered and concluded that it was appropriate to punish innocent third parties.[27] The exemption authority provision as well as the certificate of compliance provision reflect Congress' obvious intention *not to punish innocent, good faith purchasers of hot goods.* Pet. Br. 28-32; note 24, *supra.* Those provisions *were not the subject of any criticism,* and, therefore, their omission cannot reasonably support any inference of a deliberate decision by Congress to punish innocent third party purchasers.

Finally, the Secretary argues that the 1949 amendment reflects a deliberate intention to punish innocent purchasers, because "[i]f Congress had wanted to create a broader exemption for *all* good faith purchasers, or for secured creditors, it surely knows how to do so." Resp. Br. 31. Congress properly addressed the problem presented; until 1966 neither the Secretary nor anyone else had suggested that Section 15(a)(1) could be invoked against an innocent secured creditor. Pet. Br. 36-37 & n.56. There was no need to provide a broader exemption than was necessary to address the problem presented.

As discussed in petitioner's opening brief, the specific purpose of the 1949 Amendment was to correct an error by the Secretary's predecessor, who had attempted to apply the Act to one group of innocent purchasers to whom it was not intended to apply. There is nothing in the legislative history and nothing in common sense which would support the proposition that in correcting the error the Administrator made in applying the statute to one group of innocent purchasers, Congress thereby endorsed the Secretary's view as to other innocent parties. Congress in 1949 did not, as the Secretary suggests, add a sepcific execption for certain innocent purchasers.

[27] As the Secretary acknowledges, the provision would not have applied in the circumstances of this case (Resp. Br. 27-28 n.17), in any event. Pet. Br. 30 n.41.

Rather, it overrode the Administrator's erroneous view that the Act was ever intended to apply to such purchasers, absent extraordinary efforts to police compliance with the FLSA by their sellers.[28] The Secretary's contrary position is nothing more than a refusal to face up to the legislative history of the 1949 amendment. Pet. Br. 32-37, & App. 1a-5a.[29]

[28] The Administrator's pre-1949 enforcement policy is correctly described in petitioner's opening brief. Pet. Br. 33-34 and nn.48-49. The Secretary apparently contends (Resp. Br. 29-30 n.18) that the Administrator's statement was an expression of *enforcement policy only* with respect to the theoretical possibility of a criminal action for "willful" violation of Section 15(a)(1). In the far more likely context of civil injunctive proceedings, the Secretary suggests the statement was merely a meaningless collection of helpful hints as to how to avoid purchasing hot goods. According to the Secretary, the Administrator's statement of enforcement policy meant that an innocent purchaser of hot goods would not be criminally prosecuted if he had undertaken the "suggested" policing efforts, but he would remain subject to injunction, notwithstanding those efforts.

The express purpose of the statement was to set out the "steps which will show *an honest effort to avoid* the purchase of goods or materials manufactured in violation of the minimum wage and overtime provisions of the statute *and which will satisfy the enforcement policies* of the Administrator." BNA, *Wage and Hour Manual* 937 (Cum. ed. 1945) (emphasis added). In discussing civil injunctive proceedings, the Administrator explained "that the manufacturer desiring to comply fully with the provisions of the Act *should have some means of protection available to him so that he will not find himself with 'hot goods' on hand which he cannot ship across state lines and which because of that, may become worthless to him.*" *Id. See id.* 938, 939. Suggestions as to how to avoid *the purchase* of hot goods provide no protection in the only circumstance it makes a difference, namely, when the purchaser finds himself in possession of hot goods, notwithstanding the most diligent policing efforts.

[29] Having dismissed as meaningless the practical construction of the intended reach of Section 15(a)(1) expressed in his predecessor's statement of enforcement policy, however, the Secretary "charitably" describes the pointed criticism by Representatives Barden and Jacobs respecting the policy as "opaque". Resp. Br. 31 n.19. The statements are not opaque. They clearly and unequivocally express the view that the Administrator's reading of Section

The 1949 amendment rejects the Administrator's position by providing ordinary commercial purchasers with protection from prosecution under Section 15(a)(1), without extraordinary efforts to police compliance by their sellers. Notwithstanding the Secretary's attempt to obscure the obvious import of Congress' action, the provision does far more than provide a "less burdensome" means of protecting *against inadvertent violation* of the Act. It "protects . . . [against] having goods . . . purchased in good faith ordered to be withheld from shipment in commerce by a 'hot goods' injunction." H.R. Conf. Rep. No. 1453, 81st Cong., 1st Sess. 31 (1949). As the Conference Report indicates, "[t]he requirement that he must have made the purchase in good faith is comparable to similar requirements imposed on purchasers in other fields of law, and is to be subjected to the test of what a reasonable, prudent man, acting with due diligence, would have done in the circumstances." H.R. Conference Report 1453, 81st Cong., 1st Sess. 31 (1949). So long as the good faith purchaser obtains a written representation from the seller that the goods were produced in compliance with the Act, no prosecution is permissible. The "affirmative duty" to obtain such a statement was consistent with existing commercial practice. Pet. Br. 36 n.53.[30]

15(a)(1) swept far too broadly. Pet. Br. 35; Pet. Br. App. 1a-2a. If the language the congressmen used is opaque, "English speech" (Resp. Br. 31) is indeed a poor vehicle for clear expression of ideas.

[30] Both the statement of Mr. Forsythe and the language of the 1949 Conference Report, on which the Secretary relies (Resp. Br. 29), reflect the broad language of Section 15(a)(1), and, of course, the Administrator's position that, absent extraordinary efforts to police compliance, honesty and good faith, in fact, were not enough to avoid Section 15(a)(1). Neither statement suggests that Congress ever intended that an innocent good faith purchaser be subject to injunction under Section 15(a)(1). Moreover, neither of those statements contradicts the Administrator's practical recognition that innocent good faith purchasers (though improperly "defined" in the statement of enforcement policy) were never intended to be punished under Section 15(a)(1).

Amicus AFL-CIO suggests that if the question had been raised in 1949, Congress would have refused to provide an exemption for secured creditors because of the extent to which secured creditors monitor certain aspects of their debtors' businesses. AFL-CIO Br. 19. The Administrator's rationale for imposing such requirements on certain ordinary commercial purchasers was identical. Pet. Br. 33 n.49. Congress rejected that rationale for ordinary commercial purchasers. There is no reason to assume it would have reached any different conclusion as to secured creditors. Unlike ordinary commercial purchasers, a secured creditor commits funds before any non-payment problem arises—possibly years earlier in the case of a term loan—and has no means of rescinding its purchase, or of avoiding possession of hot goods once a violation has occurred. In contrast, an ordinary commercial purchaser generally can turn to alternative sources of supply whenever it learns of a failure to pay wages. The suggestion that Congress would have protected individuals who exercised a choice, but denied protection to secured creditors who have no choice once funds have been advanced is implausible in the extreme.

4. The Secretary and *amicus* AFL-CIO assert that in construing the Fair Labor Standards Act, the past 50 years of history should be dismissed out of hand as of no consequence. Resp. Br. 45-46; AFL-CIO Br. 28-29. The significance of *Powell Knitting* and the uniform course of decisions over the past 20 years is that good judicial administration commands respect for settled rules of law.[31] Settled commercial practices and the expectations of parties who reasonably rely on settled law cannot be ignored. As Judge Engel suggested in his dissent, such a departure from settled law requires compelling reason. Pet. App. 15a-16a. Here there is none.

According to the AFL-CIO, no rule of law can be "settled" until decided by this Court. AFL-CIO Br. 29.

[31] The only cases noted as accepting the Secretary's theory came after the district court decisions in this case. Resp. Br. 23 n.13.

That position ignores common sense and the practical realities of judicial administration in this country. This Court cannot address every question of law raised by every litigant in every federal court in the country in a timely fashion.[32] Businesses and individuals must plan their finances, activities, and contracts based on the law as it exists. When a long-settled rule has not been the source of any practical difficulties; when there has been *no* contrary published decision in any court; and when there is as little as there is here to commend a contrary position, the legitimate expectations of businesses and individuals are entitled to consideration.

Somewhat inconsistent with the position that long-standing judicial authority is entitled to no consideration at all, the Secretary suggests that this Court defer to his interpretation of the statute. Resp. Br. 22. First, this case involves not just the FLSA, which the Secretary administers, but a substantial body of law governing the priority of creditors' claims, including both state law (Article 9, Uniform Commercial Code) and federal law (the Bankruptcy Code), as to which the Secretary has no claim to knowledge, expertise, responsibility, or deference. Moreover, the question in this case is purely a matter of statutory interpretation, on which the judiciary is the final authority.[33] An agency construction of a statute that is "inconsistent with the statutory mandate or . . . frustrate[s] the policy that Congress sought to implement," *FEC* v. *Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 32 (1981), is entitled to no deference and should be rejected. Here, the structure, pur-

[32] *See Watt* v. *Alaska*, 451 U.S. 259, 275 (1981) (Stevens, J., concurring) ("The federal judicial system is undergoing profound changes. Among the most significant is the increase in the importance of our courts of appeals. Today they are in truth the courts of last resort for almost all federal litigation").

[33] *INS* v. *Cardoza-Fonseca*, 55 U.S.L.W. 4313, 4320 (1987); *Chevron USA Inc.*, v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984); *Bureau of Alcohol Tobacco and Firearms* v. *Federal Labor Relations Authority*, 464 U.S. 89, 97 (1983).

pose, and history of the Fair Labor Standards Act of 1938 make it plain that Section 15(a)(1) was never intended to address the priority of creditors' claims against insolvent debtors or to be invoked against innocent secured creditors of insolvent debtors. Accordingly, the Secretary's position to the contrary must be rejected.

CONCLUSION

For the foregoing reasons, and the reasons set out in petitioner's opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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April 6, 1987

(6)

No. 86-88

In The

Supreme Court of the United States

October Term, 1986

CITICORP INDUSTRIAL CREDIT, INC.,

Petitioner,

v.

WILLIAM E. BROCK, SECRETARY OF LABOR, UNITED STATES DEPARTMENT OF LABOR,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR NATIONAL COMMERCIAL FINANCE ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Amicus National Commercial Finance Association will address the following question:

Whether Section 15(a)(1) of the Fair Labor Standards Act of 1938 (29 U.S.C. § 215(a)(1)) should be construed to modify the priority of creditors' claims against the assets of an insolvent debtor.

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INTEREST OF AMICUS

The National Commercial Finance Association ("NCFA") is a non-profit membership corporation organized under the laws of Delaware, with its principal office in New York.[1] NCFA is the national trade association for financial institutions that provide asset-based commercial financing and factoring. It has more than 230 members, including petitioner Citicorp Industrial Credit, Inc. ("Citicorp") and substantially all of the major "money center" and regional banks, small commercial lenders, and large publicly-held commercial lenders.

Members of the NCFA operate on a national, regional and local scale, providing both operating funds and acquisition financing to businesses, often through the financing of accounts receivable and inventory on a revolving basis. Many of these businesses are small and medium-sized enterprises which depend upon the availability of secured financing for their existence and growth. For example, inventory financing may allow a borrower to purchase inventory needed for cyclical or seasonal buildups or to supplement cash needs during periods of low volume. Similarly, secured acquisition financing in leveraged buyouts has played a major role in the decentralization and revitalization of many enterprises in relatively mature

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1 This Brief is filed with the consent of the parties; letters reflecting consent are on file with the Clerk.

manufacturing industries, and the growth of new technology in modest-sized companies.[2]

Secured financing is a significant part of the national credit market. Total outstanding financing by the commercial finance industry has increased from under $1 billion in 1955, to more than $55 billion in 1985.

The holding of the United States Court of Appeals for the Sixth Circuit in this litigation effectively establishes a secret wage lien with priority over a prior perfected security interest in inventory collateral. That holding directly affects each of the members of NCFA, and threatens serious disruption of long-established commercial practices in the asset-based financing industry.

STATEMENT

Asset-based lending in the United States today depends upon the existence of adequate collateral and the notoriety of liens on collateral securing the loans. Before extending credit, therefore, secured lenders conduct lien

[2] *See generally* Dodsworth, *How Mr. Simon Opened the Floodgates: U.S. Leveraged Buyouts,* Financial Times, Dec. 5, 1985 at 14 ("leveraged buyouts . . . have taken Wall Street by Storm"); Williams, *Leveraged Buyouts Outpace Purchases by Private Concerns,* Wall St. J., Aug. 12, 1985 at 13, Col. 2; DeAngelo & DeAngelo, *The Numbers Show Everyone Profits,* N.Y. Times, Jan. 22, 1984 Section 3 at 2, Col. 2; Brown, *Leveraged Buyouts 1983's Rage,* Wash. Post, Dec. 7, 1983 at D8, Col. 3; Waters, *The Leveraged Buyout Boom, Inc.,* Sept. 1983 at 46; *Why Leveraged Buyouts Are Getting So Hot,* Bus. Wk., June 27, 1983 at 86.

searches in the states and counties in which the prospective borrowers' collateral may be located or moved, typically including the location of the borrowers' manufacturing or selling facilities. These searches are accomplished quickly and efficiently by reviewing public records maintained at state and local government offices to determine the extent to which any prior claims would affect the lender's rights to the collateral. This procedure provides assurance that the prospective lender's interests will not be inferior to unanticipated earlier filed liens and security interests.

The lender-borrower relationship is defined by contract. In the case of large lenders these contracts, or financing agreements, can be extensive. Typically, the agreement, among other things, establishes a security interest and requires the borrower to take all steps necessary to enable the lender to perfect that security interest. In addition, such an agreement typically contains various warranties by the borrower, may provide for limited monitoring by the lender of the collateral, and specifies the lender's rights and remedies in the event of default.

Lenders require the filing of financing statements in various state and local governmental offices to perfect their security interests and thereby make their own secured positions notorious to others doing business, or contemplating doing business, with the borrower.

Monitoring of the collateral can take two forms. The primary monitoring is done by periodic reporting in writing by the borrower to the lender regarding the collateral. Large, more sophisticated lenders may conduct periodic on-site inspections and reviews of certain corporate financial records. Small secured lenders frequently do no such

on-site monitoring, relying solely on information supplied by borrowers. Such reporting and monitoring is generally limited to attempting to determine the borrower's compliance with the terms of the financing agreement, and the amount of lending availability which exists based upon the collateral.[3] Lenders generally exercise no control over how funds advanced are used by the borrower.

On-site monitoring by the lender is, however, limited both by necessity and design. Maintaining a staff of examiners or auditors on the premises of each borrower would be prohibitively expensive for lenders, and therefore ultimately for borrowers. Borrowers would obviously find such a constant intrusion into their businesses by lenders to be meddlesome and undesirable. Because secured lenders run the risk of having their interest in collateral subordinated by reviewing courts if they intrude too deeply into their borrowers' affairs, lenders likewise are not interested in such arrangements. Lenders must place a good deal of reliance, therefore, on the good faith reporting of their borrowers.

By taking the above steps, lenders seek to protect themselves against "hidden" liens and to assure repayment of their loans. The new federal wage lien imposed by the Sixth Circuit, however, is both "hidden" and indeterminate as to amount. Lenders really cannot, therefore, account for this new lien in any quantifiable way, other than to restrict available credit and seek lending opportunities in capital-intensive, rather than labor-intensive industries.

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[3] Lending availability is calculated by applying a percentage advance rate to the collateral.

SUMMARY OF ARGUMENT

Commercial lenders rely upon well understood and established law to determine how much credit to extend to borrowers and to set the advance and interest rates. The Uniform Commercial Code, adopted in forty-nine states, Puerto Rico and the District of Columbia, provides stability and predictability of legal consequences in making lending decisions in the complex area of secured lending.

The Sixth Circuit disregards decades of settled law and expectations by holding that the hot goods provision of the FLSA may be invoked against a foreclosing secured creditor. The Sixth Circuit ruling gives a super-priority and secret lien to unpaid wage claims of employees whose rights, like those of secured lenders, already are protected by state and federal law specifically governing the priority of creditors' claims against an insolvent debtor's assets. There is no basis in the purpose or policy of the FLSA for invoking Section 15(a)(1) against secured creditors.

The Fair Labor Standards Act wage lien established by the Sixth Circuit significantly alters existing lender-borrower relationships, and will have an even greater impact on future transactions. In addition to contractual changes, lenders may be forced to attempt to monitor the payroll practices of their borrowers more closely in the hope of reserving available credit for employee wage claims. If monitoring were permitted, and if it led to significant lender participation in the management decisions of the borrower, the lender risks subordination of its claims in bankruptcy. Furthermore, the increased

risk to the lender posed by potential employee wage claims would mean less available credit and higher interest rates for borrowers, and greater administrative expense for secured lenders.

The lender's need to attempt to estimate and withhold reserves for the unlimited and uncontrollable risk of unpaid wages is likely to be most serious for borrowers in temporary financial difficulties. Such businesses, particularly in labor-intensive industries, may be unable to obtain the capital needed to recover. Thus, another consequence of the Sixth Circuit's decision may be premature closing of businesses that might otherwise have survived, with resultant loss of employment.

Without any evidence that the FLSA was intended to address an insolvent employer's financial inability to pay agreed wages in excess of the minimum wage rates prescribed in the Act, or that Congress ever considered modifying the priority of creditors' claims against an insolvent debtor's assets, the Sixth Circuit adopted an unprecedented construction of Section 15(a)(1) that not only preempts the well-established body of state law that traditionally governed creditors' rights, but also conflicts with other federal statutes specifically addressing creditors' rights. To do so, the Sixth Circuit rejected the clear distinction between wage and hour standards governed by the FLSA and creditors' rights laws—a distinction that has existed since the FLSA was enacted. Furthermore, the Sixth Circuit adopted its novel reading of Section 15(a)(1) without any suggestion that the bright line firmly established in the *Powell Knitting* decision 20 years ago had been the source of any difficulty, either in the

administration of the FLSA or in the achievement of the Act's purpose to establish minimum wage rates.

ARGUMENT

THE FAIR LABOR STANDARDS ACT SHOULD NOT BE CONSTRUED TO MODIFY THE RELATIVE PRIORITY OF CREDITORS' CLAIMS AGAINST THE ASSETS OF INSOLVENT DEBTORS.

A. Powell Knitting Was Correctly Decided in 1966.

Twenty years ago the Second Circuit correctly rejected the position the Secretary has revived in this litigation.[4] In *Wirtz v. Powell Knitting Mills*, 360 F.2d 730 (2d Cir. 1966), the Secretary moved to restrain Powell Knitting Mills and its secured creditor, Meinhard Commercial Corp., from violating Section 15(a)(1) of the FLSA by transporting goods claimed to have been produced in violation of the minimum wage provisions of the Act.[5] The district court denied relief. The Second Circuit affirmed, holding that a secured creditor could not be enjoined under

[4] Amicus National Commercial Finance Association fully subscribes to the argument that the Fair Labor Standards Act was not intended to address the relative priority of creditors' claims against the assets of insolvent debtors, which is presented in the brief on the merits submitted by petitioner. Accordingly, that discussion is not repeated here.

[5] As in this litigation, the tenuous "violation" asserted was the insolvent employer's financial inability to pay agreed wages in excess of the statutory minimums prescribed in the FLSA—or, indeed, any wages at all.

Section 15(a)(1) of the FLSA from enforcing its lien on inventory collateral by sale.

The Second Circuit excepted "foreclosing" secured creditors from the FLSA, although it acknowledged that a "wooden" reading of the FLSA could produce an opposite result. The Court found no connection between the asserted violation of the FLSA and the foreclosing secured creditor, and refused to condone the Secretary of Labor's "backhanded" attack on Meinhard's secured position. 360 F.2d at 732; *accord, Shultz v. Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971); *Dunlop v. Sportsmaster, Inc.*, 77 Lab. Cas. (CCH) ¶ 33,293 (E.D. Tenn. 1975).

In *Powell Knitting*, the Second Circuit recognized the distinction that has existed since the FLSA was enacted 50 years ago between creditors' rights law and wage and hour legislation. That distinction is as compelling today as it was in 1966. There is no reason to reconsider the well-settled rule of law firmly established in *Powell Knitting*.

B. Establishing a Federal Wage Lien Would Produce Significant and Undesirable Consequences for the Commercial Finance Industry That Congress Could Not Have Intended.

1. State and federal laws governing the priority of creditors' claims are well-established and provide the stability essential to the industry.

Commercial finance industry practices and financial products are based on the well-established body of state and federal laws specifically governing the priority of creditors' claims against the assets of insolvent debtors. Article 9 of the Uniform Commercial Code, the Bankruptcy

Code, and the Federal Tax Lien Act of 1966 are three of the principal sources of law in this area. The substantive and remedial provisions of the Fair Labor Standards Act, however, were directed at the unrelated problems of oppressive wages paid and hours imposed by ongoing businesses. Overlaying the Fair Labor Standards Act in the complex area of creditors' rights law will seriously disrupt existing commercial practices, and may produce significant changes in the practices and products of asset-based commercial lenders.

In evaluating a proposed loan transaction, reliable assessment of risk is fundamental to rational decision-making. One significant factor in evaluating the risk of asset-based financing is the amount of any senior claims against the prospective borrower's assets. If the borrower suffers financial difficulties, senior claims will be paid first. Therefore, in evaluating a proposed loan it is essential for a lender to be able to identify other claims against the assets, and the relative priority of those claims to his own.

Article 9 of the Uniform Commercial Code provides the stability and certainty that are essential to the availability of modern secured lending, particularly to small businesses for which credit otherwise might be unavailable. The UCC permits commercial lenders to determine the risks associated with proposed loans from superior liens quickly and efficiently by reviewing public filings. Two of the most significant achievements of the UCC are: first, the virtual elimination of "secret" liens; and, second, the establishment of readily ascertainable rules governing the priority of claims to assets. In addition, the UCC permits flexible security devices designed to satisfy modern com-

mercial needs. The UCC is a truly national law of commerce: it has been adopted in 49 states, Puerto Rico, and the District of Columbia.

Secret liens are antithetical to a sophisticated market for credit and other financial services. The filing system for recording security interests established under the UCC is critical to the operation of the modern commercial lending industry. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 739 (1979). The filing system, together with the priority rules established in Article 9, have made the problems caused by secret liens insignificant. Similarly, prior to the almost universal enactment of the UCC, disputes over the relative priority of creditors' claims were common. For the most part, those disputes have been resolved by the UCC with respect to personal property interests, such as inventory collateral. Under Article 9, a perfected security interest is senior to an unsecured claim for wages, and therefore the security interest would be paid in full before a wage claimant could receive any of the proceeds of the collateral. *See* Uniform Commercial Code § 9-301.

The Federal Tax Lien Act of 1966, 26 U.S.C. § 6321, *et seq.* is another of the principal statutes on which the practices of the commercial financing industry rest. The Tax Lien Act establishes a detailed set of rules governing the relative priority of private security interests and those of the United States. Under the tax lien statute a prior perfected security interest is senior to a tax lien. *See* 26 U.S.C. § 6323(a), (c).

The federal Bankruptcy Code, 11 U.S.C. § 101, *et seq.*, is another important source of law on which the practices

and offerings of the commercial financing industry depend. The Bankruptcy Code prescribes the order of priority for claims to the assets of a bankrupt. Under the Bankruptcy Code, a perfected security interest holder is senior to wage claimants and, except under very carefully limited circumstances, the security interest is not subject to impairment in bankruptcy proceedings. See pages 16-17, *infra*.

2. The FLSA wage lien will disrupt the operation of law governing the priority of creditors' claims and significantly affect commercial lending practices.

Under the Sixth Circuit rule, the newly created Fair Labor Standards Act wage lien is senior to a prior perfected security interest, thus reversing the order of priority prescribed under the UCC, the Bankruptcy Code, and the Tax Lien Act.

Because the wage lien created by the Sixth Circuit is "secret," a prospective creditor has no practical means of identifying the lien. It arises upon an employer's nonpayment of wages, without any action on the part of the employee. When a prospective creditor proposes to advance money he has no way of knowing whether the borrower has failed to pay his employees or, more importantly, whether at some point in the future he will fail to do so, thus creating a superior wage lien.

Further, the wage lien is unlimited and unpredictable in amount. The proceeds from a secured creditor's inventory collateral may be totally consumed by employee wage claims. The lien is also unpredictable in another sense. Its existence depends entirely on the action of the Secre-

tary in filing suit under § 15(a)(1). Thus, the risk of the Fair Labor Standards Act wage lien is totally outside the control of the creditor, and there is no practical way for a secured creditor to protect against it.

In addition, if a Congress chose to legislate a lien similar to the one created by the Sixth Circuit, it would certainly be defined and limited in ways unlike a *de facto* lien created by judicial fiat. Such legislation could borrow from state legislation which restricts employee wage liens to certain dollar "caps"[6] or to employees of particular industries.[7]

Judicial legislation of a claim, with no accompanying guidelines of how and to what extent such a claim would apply is a matter previously addressed by this Court with great caution. For example, this Court has repeatedly been reluctant to imply private rights of action in federal statutes, absent clear congressional intent that such a right should be implied. *California v. Sierra Club*, 451 U.S. 287, 294 (1981); *Universities Research Ass'n v. Coutu*, 450 U.S. 754, 770-84 (1981); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 16-21 (1979); *Touche Ross & Co. v. Redington*, 442 U.S. 560, 576 (1979); *Cort v. Ash*, 422 U.S. 66, 79 (1975). There is no evidence of congressional intent to apply Section 15(a)(1) to secured lenders.[8]

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[6] *See* Del. Code Ann. Tit. 10, § 4931 (1975) (New Castle County, $50 and one month); Minn. Stat. § 514.59 (West 1986 Supp.) ($1,000 or five weeks net wages up to $3,000, whichever is greater).

[7] *See* Ala. Code § 35-11-90 (1977) (railroad employees); Miss. Code Ann. § 85-7-1 (1985 Supp.) (agricultural employees).

[8] *See* discussion at pp. 19-38 of Citicorp's Brief.

Accordingly, the Sixth Circuit rule will affect both existing and prospective loan transactions. As to existing loans, the new wage lien threatens the adequacy of security for money already advanced. Agreements premised on the claims outstanding at the time the transaction was entered and then existing rules as to priority must be revisited in light of the potential risk of employee wage claims. Even then, however, it may not be possible to modify existing agreements to protect creditors.

The impact as to prospective agreements may be even more substantial. A potential lender may rely on the absence of claims on file against the assets of the prospective borrower only at his peril. The potential for employee wage claims is always present. Because the risk is not only out of the control of the lender, but almost impossible to estimate in advance for purposes of establishing adequate reserves, in some cases, such as in highly labor intensive businesses, the risk may be beyond feasible and commercially acceptable bounds for both borrower and lender. The result will be no financing. In other cases, to take into account the wage lien risk, lenders may demand more collateral or higher interest rates than the borrower can agree to. Again the result will be no financing.

The increased risks associated with inventory financing may lead some creditors to restrict the availability of such financing. Financing with inventory as collateral has become a standard means of obtaining working capital. Inventory and accounts receivable formed the basic collateral for Citicorp's loan to Ely in this case. Financing of that type would be diminished as a consequence of the

new FLSA wage lien. Further, it can be expected that lenders will tend to shift their working capital loans away from labor intensive industries. In a labor intensive industry, the borrower is likely to have a proportionately larger payroll compared to collateral value. Lenders can be expected to try and reduce the risk of secret wage liens by preferring to lend more to capital intensive businesses.

The restriction or possible unavailability of capital to borrowers who may be unable to obtain it elsewhere could not have been contemplated or intended by Congress when the FLSA was enacted in 1938. Such consequences have nothing to do with the purposes for which the FLSA was enacted: to establish minimum wage rates and decent working conditions.

C. Enforcing Section 15(a)(1) Against an Innocent Secured Creditor Will Not Further the Purposes of the FLSA.

1. There is no practical means for a secured creditor to police compliance by its debtors with the substantive requirements of the FLSA.

One response to the increased risk posed by the prospect of senior employee wage claims could be closer monitoring of the borrower's payroll practices, with an accompanying increased expense of administering loans. In the ordinary course, however, a lender becomes aware of its borrower's failure to pay employee wages only after the damage is done and, under the holding of the Sixth Circuit, the Secretary is entitled to an injunction against the sale of inventory collateral. In some cases, lenders advance funds and during the term of the financing agreement receive periodic reports from the borrower. Even

under those circumstances, however, the lender is not likely to learn of a missed payroll until weeks after the event, if at all. Even if the lender's examiner (if it has one) resided permanently on the borrower's premises throughout the term of the loan, the examiner would merely learn of the missed payroll earlier. He could not prevent it, particularly when financial collapse is the cause of the failure (except by advancing additional funds to pay wages, with no expectation of repayment). Furthermore, such extensive monitoring, coupled with action to direct payment to particular creditors, may produce claims that the secured lender should be subordinated to the rights of other creditors by its exercise of dominion or control over a borrower's business.[9] Thus, increased monitoring produces increased expense and additional risk, without preventing unpaid workers when an employer goes broke.

2. Shifting the risk of loss due to an employer's insolvency to creditors furthers no purpose of the FLSA.

The principal purpose of the FLSA was to establish minimum wage rates for employees. It has nothing to do with the priority of creditors' claims against the assets of an insolvent. There is no basis for the implicit assumption, that, in enacting the FLSA, Congress decided to prefer employee wage claims over prior perfected security in-

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9 *See Taylor v. Standard Gas & Electric Company*, 306 U.S. 307 (1939); *In re Process-Manz Press*, 236 F. Supp. 333 (N.D. Ill. 1964), *rev'd on jurisdictional grounds*, 369 F.2d 513 (7th Cir. 1966), *cert. denied sub nom Limperis v. A.J. Armstrong Co.*, 386 U.S. 357 (1967); A. DeNatale and P. Abram, *The Doctrine of Equitable Subordination as Applied to Non-Management Creditors*, 40 Business Lawyer 417, 432-445 (1985).

terests. Moreover, the policy choice Congress made in the Bankruptcy Act, when it did choose between preferring employees and secured creditors, suggests the opposite conclusion.

Neither the insolvent borrower nor the secured lender who will sell the goods (often at distress prices) without reference to their cost of production would be influenced by the incentive Section 15(a)(1) seeks to create, namely, encouraging compliance with the wage and hour provisions by taking the profit out of noncompliance. As in the instant case of an insolvent debtor and foreclosing secured creditor, which is typical, the debtor cannot profit because it is out of business. The secured creditor sells the goods for the best price available, which will be the same whether employee wages are paid or not.[10]

D. The Sixth Circuit Rule is Contrary to Policies Expressed in Other Federal Statutes.

1. Security interests are given priority in other federal statutes.

a. *Bankruptcy Code.* As already noted, a perfected security interest is senior to a wage claim under the Bankruptcy Code. In addition, under Section 364(d) of the Bankruptcy Code, 11 U.S.C. § 364(d), a Chapter 11 debtor may incur a debt that is secured by a lien on the debtor's property that is senior or equal to a perfected security interest only in limited and carefully-defined circumstances. Before such a new lien may be granted, Section 364(d)(1) requires notice, a hearing, and adequate protection of the secured party's interest.

[10] *See* Samuelson, *Economics* at 380 (8th ed. 1970) ("Once a bridge is built it must earn what the traffic will bear regardless of past sunk costs."); McConnell, *Economics* at 472-73 (9th ed. 1984).

b. *Tax Lien Act.* The federal tax lien statutes, 26 U.S.C. § 6321 *et seq.*, provide for a lien for unpaid taxes upon all of a taxpayer's property and interests in property. Section 6323 of the Internal Revenue Code, 26 U.S.C. § 6323, governs the priority of the federal tax lien and contains extensive provisions protecting the priority status of certain commercial transaction financing agreements, and recognizes the senior priority of prior perfected security interests, with limited exceptions.

The federal insolvency priority statute, 31 U.S.C. § 3713, expressly provides that these claims "[s]hall be paid first. . ." in liquidation proceedings, other than under the Bankruptcy Code. The unsecured federal claim has not been given priority over a prior perfected consensual lien, such as a security interest in inventory. It is difficult to conceive of a legal basis to elevate unpaid wages over unpaid federal claims. These statutes demonstrate that where Congress intends to intervene and disturb the claim priorities established by state law, it is clear in its intent and language.

2. The Sixth Circuit rule is inconsistent with the intended operation of other federal statutes.

If the "secret lien" for wages which the Sixth Circuit's rule creates were condoned, so that "hot goods" could not be sold in interstate commerce by all "persons" without exception, as decreed below:

(i) a trustee in bankruptcy could not sell inventory without first paying wages, contrary to the Bankruptcy Code;

(ii) the Internal Revenue Service could not sell inventory of a taxpayer subject to a tax lien, if there were unpaid wages; and

(iii) unpaid sellers under the Perishable Agricultural Commodities Act (7 U.S.C. § 499e(c)) and the Packers & Stockyards Act (7 U.S.C. § 196(b)) could not sell inventory processed by a defaulting buyer without first paying the wages of employees of that buyer.

These are incredible results that follow from the Sixth Circuit's reading of the intended operation of Section 15(a)(1), and could not have been intended by Congress. A secured party with a valid perfected security interest in inventory collateral, which advanced funds before any default in payment of wages and which did not control the use of the borrower's funds, is in the same position as the trustee in bankruptcy, the IRS agent, and the unpaid sellers of cattle and commodities. Federal and state statutes explicitly governing the right to dispose of property for the benefit of a secured creditor, lien creditor, and trustee for all creditors establish the priority of these claims without ambiguity.

Congress could not have intended to supersede or amend these statutes when it enacted the FLSA.

CONCLUSION

For the foregoing reasons, the judgment of the Sixth Circuit should be reversed.

Respectfully submitted,

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No. 86-88

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

CITICORP INDUSTRIAL CREDIT, INC.,
Petitioner,

v.

WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF FOR THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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BRIEF FOR THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS AS AMICUS CURIAE IN SUPPORT OF RESPONDENT *

The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), a federation of 91 national and international labor organizations with a total membership of approximately 13,000,000 working men and women, files this brief *amicus curiae* with the consent of the parties as provided for in the Rules of this Court.

SUMMARY OF ARGUMENT

I. Section 6 of the Fair Labor Standards Act ("FLSA"), requires "employers" covered by the Act to pay specified minimum wages to their employees and FLSA § 7 requires such employers to observe specified maximum hours of work for their employees. FLSA § 15(a) (1) provides, in turn, that

> it shall be unlawful *for any person*
>
> > to transport, offer for transportation, ship, deliver or sell in commerce, or to ship, deliver or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation or section 6 or section 7 . . . [Emphasis added.]

The question in this case is whether § 15(a) (1) bars a secured creditor who has foreclosed on goods from selling the goods in interstate commerce where the employees producing those goods were not paid the wages required by §§ 6 and 7. The language of the statute, buttressed by abundant evidence of its purpose requires that this question be answered "Yes".

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* Throughout this brief, "Pet. App." will refer to the appendix to the Petition for Certiorari; "Pet. Br." will refer to the Brief for Petitioner Citicorp; "C.A. App." will refer to the Joint Appendix of the parties in the Court of Appeals. Petitioner Citicorp Industrial Credit, Inc., will be referred to as "Citicorp" or "the Company".

The term "person" is broadly defined in FLSA § 3(a) to include, *inter alia*, a "corporation" such as petitioner, Citicorp Industrial Credit, Inc. Congress deliberately chose the all-encompassing word "person" to identify the targets of § 15(a)(1) in contrast with §§ 6 and 7 which are aimed only at "employer[s]". A court may carve out an exception to such unambiguous language only where it is "essential to prevent 'absurd results' or consequences obviously at variance with the policy of the enactment as a whole." *United States* v. *Rutherford*, 442 U.S. 544, 552. And taking Congress at its word in construing § 15(a)(1) is wholly consistent with, and necessary to effectuate, the policy of that section and of the FLSA as a whole. As explained in *United States* v. *Darby*, 312 U.S. 100, 115:

> The motive and purpose of [§ 15(a)(1)] are plainly to make effective the Congressional conception of public policy that interstate commerce should not be made the instrument of competition in the distribution of goods produced under substandard labor conditions, which competition is injurious to the commerce and to the states from and to which the commerce flows.

Darby's understanding is, as we show, abundantly supported by the legislative history of the FLSA, from President Roosevelt's May 24, 1937 message through the Congressional Hearings, Committee Reports, and debates. These legislative materials refute Citicorp's central thesis that § 15(a)(1) "is only a mechanism to encourage compliance [by employers] with substantive requirements prescribed elsewhere in the Act." (Pet. Br. 16.)

That legislative history also provides no support whatsoever for Citicorp's view that "innocent purchasers" (a category to which Citicorp says it belongs) were not to be covered by § 15(a)(1). This theory is predicated, in part, on the language and legislative history of what became FLSA § 3(i), which excludes from the definition of "goods" only those which are in the "actual physical possession of the *ultimate consumer* . . ." It

rests also on provisions in bills which were not enacted, and which would not have protected persons in Citicorp's position even if they had been.

Citicorp's reliance on the legislative history of a 1949 amendment, which excepts from § 15(a)(1) sales "by a purchaser who acquired [the goods] in good faith reliance "on written assurance from the producer that the goods were produced in conformity with the Act," and "without notice of any . . . violation" of the Act, is doubly misguided. That amendment does not go so far as to protect Citicorp here, and the statements on which Citicorp relies, made by three Congressmen in the 1949 House Hearings, are plainly not a part of the legislative history of the Act as adopted in 1938. See, *e.g.*, *Oscar Mayer Co. v. Evans*, 441 U.S. 750, 758; *United States v. Price*, 361 U.S. 304, 313.

II. Citicorp attempts to recast the issue in this case by asserting that under the decision below § 15(a)(1) grants employees who have not been paid the wages due them under the FLSA a "priority" in the goods superior to that which a secured creditor has under various state and federal laws by virtue of its perfected lien on those goods. The Court of appeals made no such error. *That court did not dispute that Citicorp lawfully possesses the goods on which the Company foreclosed; and the court below did not grant Ely's employees (or the Secretary) any possessory interest in those goods.* It said:

> Our holding does not change the priorities in bankruptcy. Citicorp "owns" the goods. The "hot goods" provision merely prevents Citicorp from shipping, delivering or selling the goods in interstate commerce. [Pet. App. 10a.]

The decision below does not interfere with any of the "creditors' rights" (Pet. Br. 2) which are governed by states through Article 9 of the Uniform Commercial Code. The Code does not give foreclosing creditors a right to sell goods which public law would forbid the debtor to sell if he were their owner; nor did any of the state uniform laws which were in effect in 1938, when

§ 15(a)(1) was enacted, do so. More generally, neither the Code nor its predecessors regulate at all the conditions under which it is lawful or unlawful to sell goods in interstate commerce; that is Congress' prerogative, exercised in § 15(a)(1). "Secured creditors such as Citicorp take their security subject to the laws of the land," (Pet. App. 33a, 25a), including the FLSA. Thus, to construe § 15(a)(1) according to its terms to include goods which are in the possession of secured creditors does not preempt any state creditors' rights law or conflict with any federal statute.

Citicorp's characterization of itself as "innocent" is immaterial, because, except with respect to good-faith purchasers without notice, § 15(a)(1) does not distinguish between innocent "persons" and non-innocent "persons" who ship substandard goods in interstate commerce. Moreover, Citicorp's claim of innocence is wholly unjustified. Under the arrangement between Citicorp and the borrower/employer Ely, all of the latter's expenses, including the payroll, were financed from funds advanced by the lender. When Citicorp, after deciding to cut off Ely's funds, permitted Ely to continue to produce goods, the company knew that the employees could not be paid for working. Citicorp expected to profit from this unpaid labor because all receivables were paid into a Citicorp bank account, and Citicorp planned, if it became necessary to foreclose, to sell the goods "and apply the proceeds against the outstanding Ely loan balance," (Pet. Br. 5).

At the end, petitioner urges this Court not to "re-examine" the 1966 ruling in *Wirtz v. Powell Knitting Mills*, 360 F. 2d 730 (C.A. 2), which held that § 15(a)(1) does not apply to secured creditors and which the Sixth Circuit herein after careful consideration "refuse[d] to follow" (Pet. App. 7a-11a). Citicorp's suggestion is as revolutionary as it is desperate, for it reverses the hierarchical relationship among the federal courts. Finally, Citicorp's contention that *Powell Knitting* should not be re-examined because the Secretary of Labor's interpretation of § 15(a)(1) would adversely affect commercial lending practices carries its own death wound. It would certainly have been contrary to the 1938 Congress' policy to enable employers to borrow money more cheaply by permitting the lender to place into commerce goods produced by workers who have not received the wages prescribed by the FLSA.

ARGUMENT

I. The Court Of Appeals' Construction Of § 15(a)(1) Of The Fair Labor Standards Act Is Faithful To Its Broad And Unambiguous Language And To Congress' Equally Broad and Clearly Articulated Policy

A. Section 206 of the Fair Labor Standards Act, 29 U.S.C. § 206, requires "employers" covered by the Act to pay specified minimum wages to their employees, and FLSA § 207, 29 U.S.C. § 207, requires such employers to observe specified maximum hours of work for their employees. FLSA § 15(a)(1), 29 U.S.C. § 215(a)(1), provides, in turn

> . . . that it shall be unlawful *for any person*—
>
> to transport, offer for transportation, ship, deliver or sell in commerce, or to ship, deliver or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 6 or section 7, or in violation of any regulation or order of the Administrator issued under section 14; . . . [Emphasis added.]

Section 15(a)(1) does contain two exceptions to its broad scope, neither of which are claimed to apply in terms here and which we set out in the margin.[1] And,

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[1] Section 15(a)(1)'s exceptions provide that

> no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this Act shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transporta-

FLSA § 3(a), 29 U.S.C. § 203(a), defines "person" as "an individual, partnership, association, corporation, business trust, legal representative, or any organized group of persons;" § 3(d) defines "employer" more narrowly as including "any person acting directly or indirectly in the interest of an employer in relation to an employee . . ."; and § 3(i), while defining "goods" broadly, excludes "goods after their delivery into the actual physical possession of the ultimate consumer thereof other than a producer, manufacturer or processor thereof."

These interrelated provisions on their face are most naturally read as stating that § 15(a)(1)'s prohibition applies to a "corporation"—like petitioner Citicorp Industrial Credit, Inc.—whether or not the corporation is an "employer", which comes into the possession of goods produced in violation of §§ 6 or 7, which attempts to move those goods in interstate commerce, and which is not entitled to the protections afforded by the exceptions to § 15(a)(1) or to § 3(i). It is especially significant in this regard that Congress chose the all-encompassing word "person" to identify the targets of § 15(a)(1), whereas §§ 6 & 7 are aimed only at "employer[s]".

B. In *United States v. Rutherford*, 442 U.S. 544, the Court said:

> When construing a statute . . . explicit in scope, a court must act within certain well-defined constraints. If a legislative purpose is expressed in "plain and unambiguous language, . . . the . . . duty of the courts is to give it effect according to its terms." *United States v. Lexington Mill & Ele-*

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tion, offer, shipment, delivery or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of the Act, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful.

Citicorp does attempt to draw some comfort from the carefully circumscribed good faith purchaser exception (Pet. Br. 32-38); we respond to that argument at pp. 19-20.

> *vator Co.*, 232 U.S. 399, 409 (1914). *See Andrus v. Sierra Club*, [442 U.S.] 347. Exceptions to clearly delineated statutes will be implied only where essential to prevent "absurd results" or consequences obviously at variance with the policy of the enactment as a whole. *Helvering v. Hammell*, 311 U.S. 504, 510-511 (1941). *See TVA v. Hill*, 437 U.S. 153, 187-188 (1978); *United States v. Key*, 397 U.S. 322, 324-325 (1970); *United States v. American Trucking Assns.*, 310 U.S. 534, 543-544 (1940). [442 U.S. at 551-552.] [2]

Far from creating "consequences obviously at variance with the policy of the enactment as a whole," taking Congress at its word in construing FLSA § 15(a)(1) is wholly consistent with that policy. In *United States v. Darby*, 312 U.S. 100, the Court sustained § 15(a)(1) as a constitutional exercise of Congress' commerce power. That holding rested squarely on the Court's understanding of the "motive and purpose" of that provision and Congress' underlying "policy":

> The motive and purpose of the present regulation are plainly to make effective the Congressional conception of public policy that interstate commerce should not be made the instrument of competition in the distribution of goods produced under substandard labor conditions, which competition is injurious to the commerce and to the states from and to which the commerce flows. [312 U.S. at 115.]

The court below, after quoting this passage (and *Darby's* statement of the FLSA's purposes at 312 U.S. 109-110), said:

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[2] *See also, e.g., Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 643;

> This Court, in interpreting the words of a statute, has "some 'scope for adopting a restricted rather than a literal or usual meaning of its words where acceptance of that meaning would lead to absurd results . . . or would thwart the obvious purpose of the statute' . . . [b]ut it is otherwise 'where no such consequences would follow and where . . . it appears to be consonant with the purposes of the Act. . . .'" *Commissioner v. Brown*, 380 U.S. 563, 571 (1965) (citations omitted).

> Consequently, one of the reasons that Congress passed the FLSA was to exclude tainted goods from interstate commerce. Since Congress wanted to exclude goods that were produced in violation of the FLSA's minimum wage and overtime provisions from interstate commerce, prohibiting secured creditors, such as Citicorp, from shipping "hot goods" in interstate commerce furthers that Congressional intent. Accordingly, we follow the "plain language" of the statute and conclude that the phrase "any person" applies to Citicorp as a secured creditor. [Pet. App. 7a.]

Citicorp does not contend that a construction of FLSA § 15(a)(1), which bars goods from interstate commerce if those goods were produced under substandard labor conditions, without regard to whether the "person" seeking to sell or transport the goods is the employer who produced the goods, or a secured creditor of that employer, would conflict with the purpose of § 15(a)(1) as thus delineated in *Darby*, or the policy of the FLSA as a whole. Rather, Citicorp offers its own highly restrictive view that § 15(a)(1) "is only a mechanism to encourage compliance [by employers] with substantive requirements prescribed elsewhere in the Act." (Pet. Br. 16; *see also id.* 17, 23.) This contention is manifestly untenable.[3]

[3] In the argument that follows, we indulge Citicorp's premise that applying § 15(a)(1) to secured creditors would not further the purpose of assuring employer compliance with §§ 6 & 7's wage and hour requirements. We do so to highlight the point that Citicorp's position is untenable even giving the Company its own ground. We hasten to add, however, that Citicorp's premise is contrary to the most elementary common sense. If § 15(a)(1) is given its due, a solvent employer would know that he could not use substandard goods as security to obtain new capital for his business. And, an insolvent employer would know that he could not reduce his loan balance by producing goods without paying his employees the statutorily prescribed wages because those goods could not be sold by his creditor and, of course, the secured creditor would have no incentive to allow or encourage the employer to continue to produce goods under substandard conditions, as Citicorp did here.

Citicorp's view of § 15(a)(1) cannot, first of all, be reconciled with *Darby's* authoritative exposition of the provision's purpose. Citicorp, therefore, simply ignores the passage from this Court's opinion quoted at p. 7 *supra*; an omission all the more revealing in light of the Court of Appeals' reliance thereon.[4] And while Citicorp's failure to do business with *Darby* should be dispositive in this regard, the Company's effort to confine the purpose of § 15(a)(1) is so essential to its position in this case that we shall briefly summarize the abundant legislative record which underlies this portion of *Darby*. As we show, Citicorp's revisionist version of that history (Pet. Br. 19-26) is inexcusably incomplete.

Of course, as Citicorp says, it is the purpose of the FLSA "to establish decent wages and hours for American workers." (Pet. Br. 19.) But Congress did *not* regard § 15(a)(1) merely as a mechanism providing for direct restrictions against employers only, in order thereby to encourage employer compliance with the FLSA's wage-and-hour standards. On the contrary, Congress recognized, on the basis of abundant evidence, that many employers would willingly maintain fair labor standards, but could not afford to do so because the goods which they produced had to compete in the market with goods produced by other employers under substandard conditions. Thus, § 15(a)(1) was not merely "intended to enforce" FLSA §§ 6 & 7 by imposing an added direct restriction on *unfair* employers (as asserted at Pet. Br. 17), but was also, and perhaps primarily, designed to protect the competing *fair* employers. This objective was expressed again and again: in President Roosevelt's message to Congress; in the Joint Committee Hearings; in the Committee Report; and in the floor debates.

In President Roosevelt's May 24, 1937 Message to Congress, quoted in part at Pet. Br. 20, the President said also that

[4] It is noteworthy, too, that no mention of *Darby* is made in *Wirtz v. Powell Knitting Mills*, 360 F.2d 730 (C.A. 2), which the court below "refuse[d] to follow" (Pet. App. 7a).

to protect the fundamental interests of free labor and a free people, we propose that only goods which have been produced under conditions which meet the minimum standards of free labor shall be admitted to interstate commerce. *Goods produced under conditions which do not meet rudimentary standards of decency should be regarded as contraband and ought not to be allowed to pollute the channels of interstate trade.* [81 Cong. Rec. 4960, 4961, emphasis added.]

Assistant Attorney General Robert H. Jackson, the Administration's opening witness in support of fair labor standards legislation, began his testimony by observing that, in the Sherman Act and the other antitrust laws, Congress had, in the exercise of its commerce power, "prohibited certain practices deemed injurious to competition in interstate commerce". He continued:

> What, then, may be said of the employer who cuts wages, employs children, and sweats labor, for the purpose of gaining a competitive advantage in marketing his product in an interstate market? As pointed out by . . . students of constitutional law, since Congress has the power to regulate conditions of competition as it has done through the antitrust acts, it may likewise prohibit the securing of a competitive advantage in interstate commerce through the adoption of oppressive and sweatshop labor conditions.[5]

Returning to this point, he said that the bill also attempts under the philosophy of the antitrust laws, to protect the man who is engaged in interstate commerce on a fair and lawful basis from the competition of those who would go into it on an unfair basis."[6] Since goods which were produced under substandard labor conditions were to be

[5] Joint Hearings before the Senate Committee on Education and Labor and the House Committee on Labor, 75th Cong., 1st Sess., on S.2475 and H.R. 7200, *bills to Provide for the Establishment of Fair Labor Standards in Employment in and Affecting Interstate Commerce*, at 3 (Testimony of Robert H. Jackson).

[6] *Id.* at 18.

barred from interstate commerce in order to protect fair competitors in other states, the identity of the seller did not matter any more than it would with respect to the sale of other "contraband".[7]

Mr. Jackson, in a passage quoted selectively by Citicorp (Pet. Br. 27-28), said, too:

> *Even if they* [employers who produced goods under substandard conditions] *do not intend* [that these goods be sold in interstate commerce] *and* [the goods] *still do enter into the competition, those unfair goods are excluded from interstate commerce*, and the fact that you change the title by selling them from A to B before they go into interstate commerce does not affect it. If you did, of course, the law would be a nullity, because they could farm out the parts of the work that they wanted to do under substandard conditions.[8]

It is, of course, Citicorp's position that "the fact that you change the title . . . from A to B" through a loan transaction does "affect" the reach of § 15(a)(1).

In the Joint Committee Hearings, the President of Johnson & Johnson added:

> . . . In all the discussions which have taken place regarding better wages and shorter hours, I have heard but one good reason for paying low wages and

[7] *Id.* at 58 (reiterating the President's characterization).

[8] *Id.* 87 (emphasis added to show Citicorp's omissions). By presenting portions of the foregoing out of their original order, and omitting that which we have emphasized, Citicorp seeks to attribute to Mr. Jackson the view that § 15(a)(1) is directed against "any person" *only* (["f]or that reason") to prevent evasion through subcontracting. (Pet. Br. 27-28.) But that position does not take full account of what Mr. Jackson actually said; his point was that § 15(a)(1)'s prohibition is applicable even if the substandard producer does not intend that the goods be sold in interstate commerce, *viz.*, even if there is no intent to evade the prohibition against such sale. Citicorp's narrow reading is refuted also by Mr. Jackson's explanation of the overall theory of the fair labor standard bill.

working long hours, and that is because some competitor down the street is doing so. . . .[9]

A former member of the New York State Minimum Wage Board explained that state minimum wage orders had largely been restricted to service industries and retail stores, in substantial part because

> In administering State wage laws we have had to realize that a neighboring State holds open arms to an employer who feels the pressure of higher standards at home. . . . It is because of this competition which extends beyond State boundaries that Federal regulation of labor standards in interstate commerce is necessary—not as a substitute for State regulation, but as an addition to it.[10]

The Solicitor General's brief in the *Darby* case quoted the testimony cited at nn.9-10, *supra*, and cited about twenty additional items of testimony in the Joint Committee Hearings alone to the same effect. Brief for the United States, No. 82, Oct. Term 1940, pp. 32-34, and n.45, cont.

So, too, the House Committee Report, in explaining the urgency of enactment of a wage and hour bill "during the present session of Congress" stated:

> In the last few months, there has occurred an alarmingly sharp decline in business activity. With that decline have come the inevitable wage cuts which the great mass of American businessmen so deplore but are powerless to prevent. These businessmen know that wage cutting sets in motion a vicious spiral of deflation which, if allowed to gather sufficient strength, may threaten the foundations of government itself.
>
> The Federal Government cannot and should not attempt to regulate the wages of all wage earners

[9] Joint Hearings at 95 (Testimony of Robert Johnson).

[10] *Id.* at 365 (Testimony of Elinore M. Herrick): Like testimony was given by a member of the Wisconsin Trades Practice Commission and the Federal Commissioner of Labor Statistics. *Id.* at 413 (Testimony of Fred M. Wylie); *id.* at 312-313 (Testimony of Isador Lubin).

> throughout the United States. But the Federal Government cannot by its inaction permit the channels of commerce to be used to set this spiral of deflation in motion. It cannot and should not permit our great interstate industries to become engulfed. It cannot in silence see the channels of commerce used to spread suffering and destitution.[11]

The mechanism by which the "channels of commerce . . . spread suffering and destitution" was the competition between goods produced for extremely low wages and goods produced at decent wages.

Against all this, Citicorp quotes from Senator Black's opening speech in the Senate debate on the wage and hour legislation (Pet. Br. 31, n.24). But the Senator there made clear that protecting fair employers from unfair competition was a major objective of the bill. Early in his speech he read into the record a letter from an Alabama lumber operator who supported wage-and-hour regulation. That letter said, in part:

> There is prevailing in the lumber industry in the South today a variance in wages of common labor in sawmills and the lumber industry of 10 cents per hour to 27½ cents per hour and weekly hours of 40 to 60 per week.
>
> This difference in wages and hours makes a very unfair competition between producers and has a tendency to lower wages and increase hours per week. It makes hard competition for the mill that wants to shorten hours and pay good wages. [81 Cong. Rec. 7648.]

A colloquy between Senator Black and a colleague is also revealing:

> Mr. WALSH. In other words, one of the objectives of the bill is that the progressive employers in good standing will not be subjected in the public market to competition with chiselers and sweatshop operators. Therefore, the board will seek to correct

[11] H.R. Rep. No. 2182, 75th Cong., 3rd Sess. at 6.

such a condition by compelling competitive employers to reach the same or better labor standards.

Mr. BLACK. The Senator is correct. . . . [81 Cong. Rec. 7651.] [12]

On the basis of the evidence just summarized, Congress, in FLSA § 2(a), made five findings, of which we set forth those which are presently most pertinent:

> [T]he existence, in industries engaged in commerce or in the production of goods for commerce, of labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers (1) causes commerce and the channels and instrumentalities of commerce to be used to spread and perpetuate such labor conditions among the workers of the several States; . . .; (3) constitutes an unfair method of competition in commerce; . . .; and (5) interferes with the orderly and fair marketing of goods in commerce. [FLSA § 2(a), 29 U.S.C. § 202 (a).]

In short, as the Court recognized in *Darby* (see p. 7, *supra*, quoting 312 U.S. at 115), the sale in commerce of goods produced under substandard conditions is itself one of the major evils at which the FLSA is directed.[13] Section 15(a)(1) directly addresses that evil

[12] Citicorp wrests out of context Senator Black's statement that the Senate Committee unanimously agreed to "limit the bill strictly to minimum wages, maximum hours, and child labor . . . ." (Pet. Br. 21, n.24.) Senator Black there pointed out that the Committee had decided not to consider provisions "which would have been, in effect, amendments to the Wagner Act." *See* 81 Cong. Rec. 7658-7659. The bill was "limit[ed] in that sense only.

[13] Later, in discussing § 15(a)(2), the Court reiterated:

> As we have said, the evils aimed at by the Act are the spread of substandard labor conditions through the use of the facilities of interstate commerce for competition by goods so produced with those produced under the prescribed or better labor conditions; and the consequent dislocation of the commerce itself caused by the impairment or destruction of local businesses by competition made effective through interstate commerce. [312 U.S. at 122.]

by prohibiting such sales by any "person" rather than only by "employers".[14]

C. As an alternative line of defense against FLSA § 15(a)(1)'s plain words, Citicorp states that §§ 6, 7 & 15(a)(1) are "aimed *principally* at ongoing solvent businesses." (Pet. Br. 17, emphasis added.)

This theory proves too little to be material here. If §§ 6, 7 & 15(a)(1) were not *exclusively* so aimed, Citicorp cannot prevail. And Citicorp, for good reasons, is

[14] Having said at Pet. Br. 16 that § 15(a)(1) "is only a mechanism to encourage [employer] compliance . . .," Citicorp later adds that requiring employers to provide fair conditions in their direct dealings with their employees is also "the jurisdictional basis" of the FLSA (*id.* at 24). This is all part of Citicorp's effort to disparage the "reference to 'competition' in Congress' finding and declaration of policies" as a mere "attempt to bring the prescription of wages and hours within Congress' constitutional power to regulate interstate commerce, and to invoke every 'hopeful approach to constitutionality' for prescription of wages, overtime and child labor standards." (*Id.* at 25.)

Insofar as Citicorp attempts to minimize the weight to be given those findings in construing the statute, that attempt: (1) is foreclosed by *Darby*, which determined the purpose of the Act from those findings (312 U.S. at 109; *see also id.* at 115 and 122, both quoted above); (2) ignores the copious evidence underlying those findings; and (3) more fundamentally, invites this Court to exceed its judicial function in construing statutes as enacted by Congress.

Moreover, insofar as Citicorp is saying that § 15(a)(1) was enacted in part because Congress believed the ban on the interstate movement of unfair goods to be a constitutional means for protecting fair employers in one state from the competition of goods produced at unfair wages in another state, Citicorp is correct, but its point reinforces, rather than cuts against, the conclusion that "any person" means all that the words say. For, insofar as Congress was concerned that other provisions of the Act—for example, § 15(a)(2), which prohibits "employers" from violating §§ 6 & 7 standards—might be held to be unconstitutional, it would have been self-defeating for Congress to permit any exceptions lest some goods which are produced under substandard conditions slip through the law's net to reach the stream of interstate commerce.

not bold enough to assert that the word "employer" in §§ 6 & 7 refers solely to an "ongoing solvent employer." [15]

It has been understood from the beginning that the "Act does not exempt employers who are in financial difficulties." *Torres v. American R. Co. of Puerto Rico*, 157 F.2d 255, 256 (C.A. 1) *cert. denied*, 329 U.S. 782.[16] There is, indeed, an especially great need to subject such employers and the goods they produce to §§ 6, 7 & 15(a)(1) (as well as other provisions of the Act). An employer who is in danger of going out of business and/or is insolvent is especially likely, due to his economic necessity, to pay substandard wages. The goods manufactured by such employers have, moreover, the same adverse impact on fair competitors in the interstate market as goods produced under substandard conditions imposed by employers who *can* comply with the statutory labor standards but choose not to do so. On both these counts it is inconceivable that Congress—attempting to stop a deflational spiral at the time the FLSA was enacted (see pp. 12-13, *supra*, quoting the House Committee Report) —would have excluded from the FLSA's coverage this important class of potential violators or have allowed the goods which such employers produce to be distributed in interstate commerce by "any person".

D. Citicorp argues, too, that the 1938 legislative history shows that Congress determined that "innocent purchasers" are not to be subject to FLSA § 15(a)(1), and that Citicorp is such an "innocent purchaser". (Pet. Br. 28-32.) This theory is predicated in part on FLSA § 3(i), as enacted, and in part on provisions contained

[15] Section 15(a)(1) applies only to goods that were produced in violation of §§ 6 or 7; thus, a showing that the employer here was not subject to those provisions would have provided a complete defense to Citicorp.

[16] There, the First Circuit reversed the District Court's dismissal of an FLSA § 16, 29 U.S.C. § 216, suit by employees to recover the wages due them from an employer who, as the District Court found, "had paid all it could pay 'and thereafter continue operations or avoid insolvency' ". (157 F.2d at 155.)

in the 1938 fair labor standards bill as "introduced and reported out of Committee in both Houses," which were *not* enacted. (*Id.* at 29.) Citicorp's argument is entirely baseless.

First, it is clear that none of the provisions cited by Citicorp were proposed to create an exemption for secured creditors in general or for persons similarly situated to Citicorp in this case in particular. The definition of "goods" quoted at Pet. Br. 29 excludes only goods "after their delivery into the actual physical possession of the *ultimate consumer* other than a producer, manufacturer, or processor thereof," (emphasis added). Citicorp is not the ultimate consumer of the goods at issue here.[17] Turning to the second cited provision (*id.*), Citicorp does not have a "Certificate of Compliance" with the FLSA's wage-and-hour standards either from the proposed Labor Standards Board (as the bill left the committees) or from the producer of the goods (as provided in an amendment adopted on the Senate floor). (*Id.*) Nor, of course, could such a certificate have been obtained here since in fact the goods were *not* produced in compliance with §§ 6 & 7. Finally, Citicorp would not have been eligible for exemption by the Labor Standards Board under the third provision cited (*id.* 29-30), since Citicorp does not, and could not, claim that it "had no reason to believe that any substandard condition existed in the production of the goods."

Thus, no exemption for Citicorp could have been extrapolated from these provisions, singly or in combination, even if the provisions had all become law. Indeed, each of these provisions was narrowly drafted out of "manifest concern" (*cf.* Pet. Br. 31) to avoid creating a

[17] The phrase, "actual physical possession" and the emphatic modifier, "ultimate", are plainly designed to prevent any evasion whereby the goods could be resold in interstate commerce; the phrase, "other than the producer, manufacturer or processor thereof" makes assurance double sure that all such persons will not be treated as an "ultimate consumer".

loophole through which "hot goods" could slip into interstate commerce.

Additionally, only *one* of these provisions was enacted: the definition of "goods" quoted at p. 16, *supra*, which is now FLSA § 3(i). That provision does not even remotely cover Citicorp and, as we have already explained, states the most carefully guarded of exceptions. Section 3(i) thus confirms what is plain from §§ 15(a)(1)'s prohibition and from § 3(a)'s definition of "person"; *viz.*, that Congress *did* "draft the Act broadly to avoid circumvention" (*cf.* Pet. Br. 28).

Citicorp would draw a different lesson. Enactment of the bill without protecting innocent purchasers *in addition* to those protected by § 3(i) and by the § 15(a)(1) exception for common carriers would, says the Company, have been "a dramatic change of policy [which] surely would have prompted at least one comment." (Pet. Br. 31.) Hence, the proper inference from the enactment of these limited exceptions and the non-enactment of other limited exceptions, according to Citicorp, is that Congress intended a general innocent purchaser exception. (*Id.*)

It is a startling suggestion that Congress' unexplained refusal to enact provisions contained in a *committee* bill—which, of course, does not establish *Congressional* policy—gives rise to the inference that Congress nevertheless intended to embody the "policy" of the provisions into law; if any inference from such a sequence is permissible, it is that Congress *rejected* such a "policy". The most appropriate course, however, is to draw neither inference and to construe the statute according to its terms. That is what the court below did, and that is the course that acocrds with the teachings of this Court. In *Gemsco Inc. v. Walling*, 324 U.S. 244, 260, in construing another provision of the FLSA, the Court declared:

> The plain words and meaning of a statute cannot be overcome by a legislative history which, through strained processes of deduction from events of wholly ambiguous significance, may furnish dubious bases for inference in every direction.[18]

E. Citicorp discusses at length the legislative history of a 1949 amendment to FLSA § 15(a)(1) which, as noted at the outset, exempts from its prohibition

> a purchaser who acquired [the goods] in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of the Act, and who acquired such goods for value without notice of any such violation.

Citicorp does not claim that the foregoing exception protects the Company in this case. Citicorp cannot so claim for two reasons which appear on the face of the amendment: (1) Citicorp does not have, and could not have received, "written assurance from the producer that the goods were produced in conformity with the requirements of the Act."; (2) Citicorp did not acquire the goods "without notice" of the producer's violation. Citicorp and similarly situated secured creditors differ from the good-faith purchasers who are protected by the 1949 amendment also in a third way, which appears to have been critical to its proponents: Unlike arms-length purchasers, secured creditors *are* in a position to know whether the borrower/employer is in compliance with the Act and *can* protect themselves against noncompliance. (See point II B, *infra*, describing this "typical commercial secured lending transaction" (Pet. Br. 3)). And while Citicorp does contend that the legislative history of the amendment "reveals that Congress rejects the basic premise of the Secretary's argument" (Pet. Br. 32), the Company's contention fails (without regard to its details) for the fundamental reason that the 1949 Congress did not work any change in § 15(a)(1)'s prohibition and that its later debates are therefore not a part of the legislative history of the Act as adopted in 1938.

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[18] *See also, e.g., Greenwood v. United States*, 350 U.S. 366, 374: "this is a case for applying the canon of construction of the wag who said, when the legislative history is doubtful, go to the statute."

The statements which Citicorp quotes, like those relied on by the losing party in *Oscar Mayer Co. v. Evans*, 441 U.S. 750, 758, were made "11 years after the [statute whose meaning is at issue] was passed . . . and such '[l]egislative observations . . . are in no sense part of the legislative history'. *United Airlines Inc. v. McMann*, 434 U.S. 192, 200 n.7 (1977)." This Court has frequently recognized that "the views of the subsequent Congress form a hazardous base for inferring the intent of an earlier one." *United States v. Price*, 361 U.S. 304, 313. *See also, e.g., Russello v. United States*, 464 U.S. 16, 26; *Jefferson County Pharm. Assn. v. Abbott Labs*, 460 U.S. 150, 165 n.27; *Consumer Products Safety Comm'n. v. GTE Sylvania, Inc.*, 447 U.S. 102 at 117-118 and n.13. As stated in *GTE Sylvania*, "[s]uch history does not bear strong indicia of reliability . . . because as time passes, memories fade and a person's perception of his earlier intention may change."

* * * *

The burden of Citicorp's case is that goods which an employer/debtor may not sell in interstate commerce because those goods were produced in violation of the FLSA are magically cleansed by foreclosure and attain greater value in the creditor's hands than they had in the debtor's. That position is contrary to the broad, unambiguous language of FLSA § 15(a)(1) and Congress' policy, effectuated by that provision, "that interstate commerce should not be made the instrument of competition in the distribution of goods produced under substandard labor conditions, which competition is injurious to the commerce and to the states from and to which the commerce flows," *United States v. Darby*, 312 U.S. at 115.

II. Citicorp Mischaracterizes The Issue Before The Court

At the outset of its tendentious statement of the case, Citicorp introduces the two dominant themes of its argument: that this is a case involving "creditors' rights;" and that the Company's "innocence" protects it from FLSA § 15(a)(1)'s restrictions (Pet. Br. 2-3). At the close of its brief (*id.* 46-49), Citicorp goes so far as to

argue that this Court should not examine the statutory issue in this case on its merits because of a decision twenty years ago by the Second Circuit; a decision whose reasoning and result the court below, after careful analysis, "refuse[d] to follow" (Pet. App. 7a-12a). These frenetic efforts to avoid the unmistakable lesson taught by the statute and its legislative history avail Citicorp nothing.

A. Citicorp accuses the court below of ignoring the "distinction . . . between wage and hour standards and creditors' rights" (Pet. Br. 2). In truth, however, it is Citicorp which predicates the major part of its case on the eradication of that distinction.

Citicorp attributes to the court below a holding that § 15(a)(1) grants employees who have not been paid the wages due them under the FLSA a "priority" in the goods superior to that which a secured creditor has under state law by virtue of its perfected lien on those goods. The Court of Appeals made no such error. *That court did not dispute that Citicorp lawfully possesses the goods on which the Company foreclosed; and the court below did not grant Ely's employees (or the Secretary) any possessory interest in those goods.* As the Court of Appeals explained, in direct response to Citicorp's claim of a conflict with the priority scheme of the Bankruptcy Act:

> Our holding does not change the priorities in bankruptcy. Citicorp "owns" the goods. The "hot goods" provision merely prevents Citicorp from shipping, delivering or selling the goods in interstate commerce. [Pet. App. 10a.]

The fact that Citicorp has the option to cure the violation of FLSA §§ 6 & 7 by paying the employees the statutorily required amounts and to thereby remove the taint from the goods, does not justify Citicorp's mischaracterization of the ruling below. (Pet. Br. 13.) In this respect, Citicorp, and any other secured creditor, is in no different position than an employer who has produced

goods in violation of §§ 6 or 7. It is common ground that § 15(a)(1) prohibits such an employer from shipping those goods, but he, too, can remove the taint by paying the employees the wages due them under the FLSA. Citicorp has not argued that § 15(a)(1) thereby creates a lien against the employer in favor of employees or grants the employees a "priority" interest in those goods superior to that of the employer. Citicorp's assertion that the decision below creates a "lien" in favor of the employees is no less artificial.[19]

The decision below does not therefore limit any of the "creditors' rights" (Pet. Br. 2), created by the states through Article 9 of the Uniform Commercial Code (*id.* 38-41). The Code does not grant foreclosing creditors a right to sell goods which public law—state or federal—would forbid the debtor to sell if he were their owner; nor, and more to the point, did any of the state uniform laws, cited at Pet. Br. 23, n.27, which were in effect in 1938, when § 15(a)(1) was enacted, do so. Neither the Code nor its predecessors regulate at all the conditions under which it is lawful or unlawful to sell goods in interstate commerce. That is a subject with which Congress has historically dealt, in part through § 15(a)(1)

[19] Likewise misleading is Citicorp's contention that what it chooses to characterize as a "lien" would be "secret" (Pet. Br. 13, 38, 39 n.59).

While the prohibition against the sale of the goods in interstate commerce, if the employees' wages are not paid, may be " 'secret' in the sense in which the term is used here," (*viz.*, in Citicorp's special vocabulary (*id.*)), it would not be "secret" in any customary usage. For that prohibition is contained in § 15(a)(1)'s unambiguous words, of which potential creditors, like the public generally, have notice. And, under financial arrangements of which this transaction is typical (Pet. Br. 3), secured creditors know, or have the means of determining, whether the employer is violating FLSA standards, and whether the goods the employer produces are potentially subject to § 15(a)(1)'s restriction (see pp. 25-27, *infra*).

It is true that § 15(a)(1)'s restriction on sale is not recorded by filing with state officials (*cf.* Pet. Br. 4, n.3); but that is because there is no "lien" to be recorded.

in regulating "wage and hour standards" (*id.* 2), and, in part, in other laws as well, and which has not heretofore been claimed to be the office of creditors' rights legislation. "Secured creditors such as Citicorp take their security subject to the laws of the land." (Pet. App. 33a, 25a.) In short, to construe § 15(a)(1) according to its terms to include goods which are in the possession of secured creditors does not preempt any state creditors' rights law.[20]

Once it is recognized that the decision below does not create any "lien" in the goods, the specters which Citicorp raises of "irreconcilable conflict between the FLSA and other federal statutes" (Pet. Br. 42), are also quickly exorcised. The Bankruptcy Code's scheme of priorities remains intact; and while, under the Code, a "trustee is obligated to liquidate the bankrupt's estate including inventory" (*id.* 43), the Code does not purport to free the trustee from the restriction of other laws in so doing. As Judge A. N. Hand wrote in *Cullen v. Bowles*, 148 F.2d 621, 623 (C.A. 2):

> It has been generally held that federal statutes regulating business in the public interest are equally applicable when the business is run by trustees or

[20] We stress, however, that if there were any state laws which would allow shipment in interstate commerce of goods which were produced in violation of FLSA §§ 6 & 7, such laws would be preempted by § 15(a)(1). Citicorp properly concedes that an Act of Congress preempts state law if to do so is "essential to accomplish the purposes of the statute" (Pet. Br. 38). Under a correct view of the FLSA's purposes the exclusion from interstate commerce of goods which were so produced *is* "essential to accomplish Congress purposes". (See pp. 7-15, *supra.*) As the Court of Appeals said:

> Congress does not want "hot goods" to taint the channels of interstate commerce. Furthermore, the "hot goods" in this case will compete with goods produced in conformity with the FLSA's minimum wage and overtime provisions if Citicorp places the goods in interstate commerce. The FLSA protects manufacturers who comply with the minimum wage and overtime provisions by keeping "hot goods" out of interstate commerce. [Pet. App. 10a.]

receivers. Thus a receiver operating a railroad has been held subject to a statute prohibiting a common carrier from transporting livestock by rail from a quarantine district to another state. *United States v. Nixon*, 235 U.S. 231; *see also Erb. v. Morasch*, 177 U.S. 594. Similarly, the receiver of a railroad has been held subject to the federal hours of labor law. *United States v. Ramsey*, 8 Cir., 197 F.144.[21]

The other federal statutes cited at Pet. Br. 44-45 are likewise irrelevant because their respective priority schemes also remain undisturbed by the Court of Appeals' construction of § 15(a)(1).[22] And since each of those statutes was enacted long after the FLSA (*see id.*), the "cardinal principle of statutory construction that repeals by implication are not favored", invoked at Pet. Br. 13-14, 42, would, if applied, cut strongly against Citicorp's position that these statutes provide a basis for narrowing § 15(a)(1). No more helpful to Citicorp is the other canon which the Company quotes (*id.* at 42-43): "where . . . statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." For, § 15(a)(1) can be applied effectively to prevent secured creditors from selling "hot goods" across state lines even if one assumes, *arguendo*, that IRS agents and sellers of cattle and other agricultural commodities are not so restricted. Nor does the possibility that the term "any person" could be construed to exclude

[21] So, too, in *Donovan v. TMC Industries, Ltd.*, 20 B.R. 997 (N.D. Ga.), the District Court granted the Secretary of Labor an injunction under FLSA § 17, 29 U.S.C. § 217, to enjoin debtors in bankruptcy from shipping goods in interstate commerce in violation of § 15(a)(1). The court rejected an argument on the part of the bankrupt defendants which is identical to that which Citicorp here bases on the Bankruptcy Code. (*See id.* at 1000.)

[22] The 1976 Amendments to the Packers and Stockyard Act ("PSA"), 7 U.S.C. § 196, and the 1984 Perishable Agricultural Commodities Act ("PACA"), 7 U.S.C. § 499e(c) cited at Pet. Br. 42, n.67 and 44-45, are of interest chiefly in illustrating that Congress is not unwilling to override state priority schemes.

representatives of the sovereign.[23] or the special beneficiaries of farm legislation, permit the conclusion (*id.* 44), that the breadth of the statutory phrase can be disregarded at the behest of secured creditors who are neither.[24]

B. (1) Citicorp repeatedly describes itself as "innocent" and sometimes even as "wholly innocent." But except with respect to good-faith purchasers without notice who are protected by the 1949 amendment to § 15(a)(1) (quoted at p. 18 *supra*), Congress has not distinguished between innocent "persons" and noninnocent "persons" who ship substandard goods in interstate commerce.[25] Thus, the Court of Appeals properly adhered to the statute in refusing to distinguish "between innocence and culpabality", as Citicorp says that court should have done (Pet. Br. 2-3). Nevertheless, since we are told that "this case arises out of a typical commercial secured lending transaction" (*id.* at 3), it may be enlightening to examine just how "innocent" Citicorp actually is.

[23] See *United States v. Cooper Corp.*, 312 U.S. 600, 606.

[24] It is far less clear to us than it is to Citicorp that if the question were ever to arise, the courts would hold that the IRS is not subject to § 15(a)(1), and may sell "hot goods" in commerce despite the effect of doing so on fair competitors. It is likewise uncertain how the courts would resolve conflicts among the respective interests sought to be protected by the FLSA, on the one hand, and the PSA and PACA, on the other.

[25] What this Court said in *Darby* with respect to § 15(a)(2) is equally pertinent here:

> Congress, to attain its objective in the suppression of nationwide competition in interstate commerce by goods produced under substandard labor conditions, has made no distinction as to the volume or amount of shipments in the commerce or of production for commerce by any particular shipper or producer. It recognized that in present day industry, competition by a small part may affect the whole and that the total effect of the competition of many small producers may be great. See H. Rept. No. 2182, 75th Cong., 1st Sess., p. 7. *The legislation aimed at a whole embraces all its parts.* [312 U.S. at 123, emphasis added]

As Citicorp acknowledges, under its agreement with Ely, "payments from Ely's customers were deposited in a Citicorp account, and applied against the advances made by Citicorp" (Pet. Br. 4, n.2). Citicorp's "advances" were made on a day-to-day basis, covering all of Ely's expenses, including the payroll. (Pet. App. 19a, ¶ 3.) On February 8, 1985, Citicorp decided (as the Company had the right to do) not to make any more advances and, on February 11, Citicorp so notified Ely (but *not* Ely's employees). On the same day, Citicorp also decided, at Ely's request, to permit the latter to continue its operations.[26] Thus, as the trial record in both cases shows and, as one District Court expressly found:

> While there is no evidence of collusion between officials of Citicorp and Ely Group, Inc., the evidence does show that Citicorp knew it was funding the payroll of Ely Group, Inc., and when this funding ceased Ely could not meet its payroll obligations to its employees. [Pet. App. 19a, ¶ 3.]

Citicorp's actual knowledge aside, under § 16(a) of its agreement with Ely, the Company had access to all of Ely's books and records, including payroll records. (C.A. App. 366) From the latter, Citicorp elected to ascertain only whether payroll taxes had been paid, and to disregard whether the employees were being paid in accordance with the FLSA's requirements. (See Pet. App. 20a, ¶ 5.)

Thus, what the Fifth Circuit said with respect to the "good faith" test under the 1949 exception to § 15(a)(1) applies with even greater force to Citicorp's attempt to secure, by judicial construction, an exception for "innocent" secured creditors:

> "Good faith" under the Act does not include ignoring the obvious. Lone Star Steel Company had the contractual right to inspect the records of the contractors at any time. A good faith effort to comply with the Act would have included checking their records and any further investigation necessary to ascertain the facts. A person or a corporation cannot take an "ostrich-like attitude" and still be in good faith under the Fair Labor Standards Act. [*Wirtz v. Lone Star Steel Company*, 405 F.2d 668, 670 (C.A. 5).]

Moreover, going beyond what Citicorp must have known, or deliberately refused to learn, the realities of the transaction makes it plain that in February 1985, and even well before, Citicorp's economic interest in the goods which were being produced at Ely's plant was, realistically, as great as Ely's interest. Since all payments by customers for goods produced and sold were made to Citicorp's bank account, those payments directly benefitted Citicorp, while reducing Ely's loan balance.[27] Citicorp knew, when the Company allowed Ely to continue operations, that if the goods to be produced were sold by Ely, it would be for Citicorp's account. On the other hand, if, as eventuated, foreclosure became necessary, "Citicorp then planned to collect Ely's receivables, and to liquidate [*i.e., sell*] the inventory collateral and apply the proceeds against the outstanding Ely loan balance of approximately $9.5 million," (Pet. Br. 5). In either event Citicorp would get the money, Ely would get a reduction of its loan balance and the workers who produced the goods would get *nothing*.

(2) Citicorp also asserts that to apply § 15(a)(1) against secured creditors would be to "punish" them *E.g.*, (Pet. Br. 28, 31) Of course, a prohibition against the sale of goods in interstate commerce is not punishment in any *legal* sense. Cf. *Kennedy v. Mendoza-*

[26] The record also shows that on February 15 Citicorp learned that some payroll checks presented by employees for work previously performed had been dishonored. (C.A. App. 303)

[27] Citicorp also received money from customers "for goods that were worked on or shipped during the period of time that employees missed payrolls in Memphis." (See C.A. App. 322).

Martinez, 372 U.S. 144, 168-169. Indeed, § 15(a)(1) does not provide for a sanction against prohibited conduct; that is the function of FLSA §§ 16 & 17. The only true "punishment" provided is in § 16(a)(1) which permits the imposition of fines and imprisonment for violations of § 15 (imprisonment being authorized only after conviction of the same crime for a prior offense under § 16 (a)(1)). It is simply not "punishment" to subject a party to economic regulation, even where that regulation costs the regulated party money.[28]

C. Because in 1966 *Wirtz v. Powell Knitting Mills*, 360 F.2d 730 (C.A. 2) held that § 15(a)(1) does not apply to secured creditors, Citicorp closes by urging that "[e]ven if there were some basis for concluding that the Second Circuit was wrong in *Powell Knitting*, judicial re-examination of the rule would be inappropriate at this late date," [29] despite disagreement therewith by another Court of Appeals in a reasoned decision.[30] This is an

[28] Even on Citicorp's theory that § 15(a)(1) creates a "lien" in favor of the employees superior to that to the secured creditor, it could not be said that the secured creditors are thereby "punished". A statutory scheme of priorities, such as the Uniform Commercial Code, does not "punish" the subordinated parties.

[29] Citicorp goes further still by asserting both at the beginning (Pet. Br. 2) and close (*id.* 47-49) that it has been settled for "nearly 50 years" that secured creditors are not subject to § 15(a)(1); the Company does so although advising, in the middle of the brief, that in 1938 "inventory and accounts receivable financing was in its infancy" (*id.* p. 23).

[30] The Sixth Circuit said: "Although we are reluctant to create an intercircuit conflict, we cannot agree with the Second Circuit's 'judicially created exception' [to § 15(a)(1).]" (Pet. App. 9a). This approach is entirely correct. As Judge Posner has recently written:

> Bearing in mind the interest in maintaining a reasonable uniformity of federal law and in sparing the Supreme Court the burden of taking cases merely to resolve conflicts between circuits, we give most respectful consideration to the decisions of the other courts of appeals and follow them whenever we can. * * * But neither this court nor the district courts of this circuit give the decisions of other courts of appeals automatic deference; we recognize that, within reason, the parties to cases before us are entitled to our independent judgment. [*Colby v. J.C. Penney Company, Inc.*, 43 FEP Cases 47, 50 (C.A. 7, Feb. 10, 1987).]

argument borne of desperation, for it reverses the hierarchical relationship among the federal courts: The "construction of a national statute" is not "settled" (*id.* 47) until it has been declared by *this* Court.[31] And, of course, under the doctrine of *stare decisis* (*id.* at 47 and 49, and nn.74-76, 79) this Court adheres to its own prior decisions but not those of inferior courts.[32]

[31] There is no basis for Citicorp's presumption that Congress was aware of *Powell Knitting* when it amended other provisions of the FLSA (Pet. Br. 46). See *Aaron v. SEC*, 446 U.S. 680, 694. Nor is "Congress' failure to amend § 15(a)(1) . . . evidence" concerning Congress' original intent in enacting the provision. See pp. 19-20, *supra*.

[32] Citicorp's extraordinary proposal that an earlier decision of a Court of Appeals should be regarded by this Court as the final word on the interpretation of a federal regulatory statute—or as entitled to greater weight than the persuasiveness of its reasoning would warrant—is the functional equivalent of a "rule allowing nonmutual collateral estoppel against the government", contrary to *United States v. Mendoza*, 464 U.S. 154, 160. Such a rule was rejected because it

> would substantially thwart the development of important questions of law by freezing the first final decision rendered on a particular legal issue. Allowing only one final adjudication would deprive this Court of the benefit it receives from permitting several courts of appeals to explore a difficult question before this Court grants certiorari. [Citations omitted.] Indeed, if nonmutual estoppel were routinely applied against the Government, this Court would have to revise its practice of waiting for a conflict to develop before granting the Government's petitions for certiorari. [464 U.S. at 160.]

Moreover, even as the rule rejected in *Mendoza* would have required substantial revision of "the Solicitor General's policy to determine when to appeal an adverse decision," so the approach for which Citicorp contends "would force the Solicitor General to abandon [the] prudential concerns "which underly his decision whether to seek certiorari in the absence of an inter-circuit conflict." *Id.* at 160, 161.

Finally, Citicorp says that *Powell Knitting* should not be re-examined because "adopting the Secretary's interpretation of Section 15(a)(1) would tend to discourage secured lending and increase the costs to borrowers", and "commercial lenders would be forced to reevaluate the adequacy of their collateral and the availability of additional funding under existing agreements, which were negotiated in reliance on the authority of *Powell Knitting*," (Pet. Br. 48). The representation that lending transactions are actually planned and priced on the assumption that the lender will receive the benefits of the unpaid labor of the borrower's employees does Citicorp and its industry little credit. And it would certainly have been contrary to Congress' policy in 1938 to enable employers to borrow money more cheaply by permitting the lender to place into commerce goods produced by workers who did not receive the wages prescribed by the FLSA. As for Citicorp's other economic arguments, "determination and evaluation of the consequences" should indeed "be left to Congress" (*id.* at 48-49).

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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